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AGRICULTURAL CREDIT

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BEFORE THE

SUBCOMMITTEE ON
AGRICULTURAL CREDIT

OF THE

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NUTRITION, AND FORESTRY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

FEBRUARY 26 AND MARCH 26, 1987

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AGRICULTURAL CREDIT

The Farm Credit System

THURSDAY, FEBRUARY 26, 1987

U.S. Senate,
Subcommittee on Agricultural Credit of the
Committee on Agriculture, Nutrition, and Forestry,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room SR-332, Russell Senate Office Building, Hon. David L. Boren (chairman of the subcommittee) presiding.

Present or submitting a statement: Senators Boren, Zorinsky, Daschle, Boschwitz, Cochran, and McConnell.

Also present: Senators Leahy, Melcher, Lugar, and Bond.

OPENING STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM OKLAHOMA

Senator Boren. We will call the hearing to order at this point. There are other members, including the ranking member, Senator Boschwitz, who planned to be here this morning, but I think we better get underway. We meet this morning to discuss a very important matter to American agriculture and to the national economy: The present condition and the future of the Farm Credit System. As everyone in this room is aware, the Farm Credit System is an important and integral part of the entire credit system for agriculture in this country, holding approximately one-third of the debt in that sector at the present time.

We are now faced with what I would call a vicious cycle. Estimates ranging from $4 to $8 billion are floating around in terms of the amount the Farm Credit System may need to keep it fully effective and fully solvent. The exact figure has yet to be determined in terms of the needs this System may have and the Federal action that may be required.

The System has had rather significant losses recently. In 1986, for example, that loss was $1.9 billion. Coupled with significant losses, there have been declines in loan volume within the System, ranging from 15 to 20 percent over the last 2 years. At the same time, interest rates prevailing in the System have been higher than those offered by many other competing lenders. This has caused many of the more high quality borrowers within the System to leave it and go to other lenders where they could receive lower rates of interest.

This means, of course, that a larger and larger proportion of the borrowers that remain in the System are those that are less able to meet their current principal and interest payments when due on their loans.

The high interest rates that continue to prevail, of course, also make it more and more difficult for those farmers, who are on the borderline, to remain in business.

This is a matter of great importance, then. We have a challenge before this committee to determine the full range of the problem, to determine its magnitude and then to determine the course of action we should follow in trying to put the System back on the right track. The chairman of this committee, Senator Leahy, has indicated to me that this matter is high on this committee's priorities for action this year.

The Majority Leader of the Senate, Senator Byrd, has also indicated that it is high on his action list this year. In fact, both of them have indicated to me that they hope we can have a legislative proposal dealing with the crisis in the Farm Credit System ready and on the calendar for action by the full Senate by before the Easter recess.

That means we are going to be moving as rapidly as possible to obtain information and to come forward with legislative proposals for dealing with the situation. It also means that all of those who are interested in the future of the System, those that are now charged with the direction of the System, the agricultural groups, the agricultural borrowers, and current members of the System who would be impacted by any change, should move as quickly as possible to give their input to this subcommittee and to the full Agriculture Committee as we work on an expedited timetable to try to get something done. As I mentioned, the greatest challenge we face is to put the System back on the right track. Any Federal action must be sufficient to correct the problems in the short term, and sufficient to avoid a future recurrence of the problems that we're now facing.

For that reason, it is imperative that we examine all aspects of the Farm Credit System from its very basic structure to its ability to obtain funding for the purpose of making loans. We must begin by asking some very basic questions. Is the original purpose of the Farm Credit System relevant today? Or, do we need to establish a new purpose or additional purposes?

We will be hearing from some who have a historic perspective on the early period of the System, its original purposes and the way it's operated in the past.

Do we want local control of the System, or do we want extreme centralization, or do we want some combination of the two with different purposes and functions for each aspect? Do we want a cooperative System, or do we want decentralization to the point that each institution survives or fails based upon its own viability, and of course, we have had efforts to pool resources in the past. We now have had, in very recent days, court decisions which are even yet defining the capability of the System under current law to share resources from one district and one bank to another.

If we want a cooperative system, do we want that even if it means decreasing the number of local associations? Do we want a System whose purpose is to provide loans to family-sized commercial farming operations? In other words, target them to those that are principally in the business of agriculture, to family farmers. Or, do we want one that concentrates on large operators, those who very often have other operations besides agriculture, or the smallest, hobby-sized operators who are not dependent upon agriculture for their income?

Do we want a System which allows some borrowers to not purchase stock, or do we want one in which everyone purchases stock? If we want to retain the cooperative nature of the System, how do we reconcile differential interest rates and the giving of some benefits to a select number of borrowers? Do we want a System that serves the borrower-owners and does everything possible to keep its current borrowers in business?

Or, do we want a System that is more concerned with the preservation of the System itself even if it means putting a large number of farmer-borrowers out of business? All of these are questions which we must address before attempting to draft legislation.

If we scratch the surface on these issues in today's hearings, we will have made an important start down the road toward an ultimate legislative solution.

Today, the Subcommittee on Agricultural Credit will be hearing testimony from a variety of witnesses on the Farm Credit System. The purpose of today's hearing is to examine the status of the Farm Credit System, including its present financial condition, and to determine whether the System is fulfilling the purpose for which it was established. If we are to approach the present problems rationally, we must understand how the System arrived at its present predicament. For this reason, it is necessary to carefully review the history of the System.

The Farm Credit System by its very nature encounters difficulties during periods when the agricultural economy is under stress. The System's loan portfolio is not diversified and was not intended to be diversified. It serves only select portions of the economy. Consequently, when agriculture as a whole is not doing well, the System is not doing well. In order to remain viable, the System must be more conservative in its operations than other lenders who have the ability to diversify their loan portfolios. The System is not and was never meant to be another Citicorp. Yet, at times, the System appears to have embarked upon policies resembling a large, commercial bank. The major difficulty the System must face is to fulfill its public purpose and remain viable. Because it does serve a public purpose, the System was chartered by Congress and it must carry out the intent of Congress. If a Federal infusion of capital is necessary to ensure this goal, then that is what must be done.

When most people are asked why the System is in trouble today, they typically state that it is due to the dramatic drop in exports and subsequent low commodity prices. This only touches on part of the problem. We must also consider how the System and the borrowers became so vulnerable to the drop in exports.

It is quite possible that some of the actions, including legislative actions, taken over the past 70 years have placed the System in its present state. We must examine these actions objectively, not to place blame on anyone for errors, but in order to learn from our mistakes and not repeat them.

For example, one of the difficulties the System has faced in the past couple of years has been the relatively high interest rates offered. Prior to the 1971 act, Farm Credit System interest rates were tied to the most recent bonds issued by the institution. In this manner, the interest rate offered to farmers and ranchers closely reflected current financial market conditions, thereby permitting System interest rates to track those of other competitors. After the 1971 act, interest rates have been based primarily on the average cost of bonds the bank has issued. By using the average cost, interest rates in the 1980's have been higher than that for other commercial lenders due to the extremely high interest rates of the late 1970's. We must ask ourselves if the change in the method of pricing interest rates was a good change.

If we were to assume that there has been no change, one could argue that the System would be competitive today and borrower-flight would not be a major problem. We would have to recognize, however, that interest rates offered by the System in the 1970's would not have been as low as they were. If that had been the case, it is quite possible that the volume of loans would not have been as great. At the same time, perhaps the System would not be in as much trouble as it is.

We must also consider two other changes that occurred in the 1970's. First, the 1971 act increased the amount of money that could be loaned on a farm to 85 percent of the appraised value. Second, the definition of "appraised value" was changed to mean "current market value" in lieu of "normal agricultural value". When one considers these two changes in combination with the pricing of interest rates, it becomes apparent that the amount of money a farmer or rancher could borrow was dramatically increased. These three changes could have pushed land values up much higher than agricultural production on the land could have sustained. In this respect, it is possible that these changes may have impacted the agricultural economy in precisely the same way that the boom in exports in the mid-1970's did.

Because of examples like the preceding, we must look at the System from all aspects. If we are going to sensibly approach the problems in the System, we must carefully examine the legislative history of the System.

The present Farm Credit System began with the enactment of Public Law 64-158, "the Federal Farm Loan Act", adopted in 1916. The stated purpose of that act is as follows: "An act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositories and financial agents for the United States, and for other purposes." The question we have to ask ourselves today is whether the present Farm Credit System is still fulfilling this original purpose.

This original act contained various provisions of interest today. For example, before anyone could borrow money, the person was required to purchase stock equal to 5 percent of the loan. In addition, the law required that the stock be redeemed at par upon payment of the loan. The interest rate charged on loans under the original act was directly tied to the most recent series of farm loan bonds issued by the land bank making the loans. The interest rate could not exceed the interest rate of the most recent series of bonds plus 1 percent for administration and profit. The law was also very specific in the terms of the loans—the amount of the loan could not be greater than $10,000, the loan could be for no less than 5 years nor more than 40 years, and the loans could not exceed 50 percent of the appraised value based on the value of the land for agricultural purposes. At that time, the actual agricultural earning power was a principal factor in determining the appraised value of the land.

Loans under the 1916 act were restricted to "farm uses". The loans could only be used to purchase land for agricultural uses, to purchase equipment for farm buildings or improvements on the farm, or to liquidate indebtedness incurred for farming. No one, not engaged in the cultivation of the farm, could obtain a loan under the act.

The cooperative nature of the System also began with the 1916 act. The particular land bank issuing a bond was primarily liable for repayment of the bond. However, if the issuing land bank became insolvent, all remaining land banks were liable for the deficit of the insolvent land bank. Each remaining land bank was assessed an amount in proportion to the amount of farm loan bonds which each remaining land bank had outstanding.

Each land bank was required to maintain reserves and examiners, following the same rules as for national bank examiners, were appointed by the Federal Farm Loan Board.

The next major legislation adopted was the Agricultural Credits Act of 1923, Public Law 67-503. Under that act, Federal intermediate credit banks were established, land bank loans were limited to $25,000, and preference was given to loans under $10,000.

In 1933, with the adoption of the Farm Credit Act of 1933, local associations offering short-term credit and banks for cooperatives were established. An Executive order issued in the same year created the Farm Credit Administration. The Farm Credit Act of 1953 established the present configuration of the Farm Credit Administration as an independent Federal agency with supervisory and regulatory powers over the Farm Credit System of privately owned, cooperatively operated banks and associations.

During the period between the original 1916 act and 1971, there were numerous other minor amendments to the law. For example, over time the percentage of the value of the land eligible for loans was increased. There was not, however, any major change until the Farm Credit Act of 1971, Public Law 92-181. As I have indicated, under the 1971 act, several changes of significance were made.

The interest rate charged on these loans were no longer tied to the most recent issue of farm credit bonds. Rather, they were determined by the board of directors of the bank with the approval of the Farm Credit Administration. Variable interest rates were authorized as well. Loans could be made for up to 85 percent of the appraised value of the real estate and the definition of "appraised value" was determined by the bank and approved by the Farm Credit Administration. As it turned out, this resulted in a switch from using "normal agricultural value" to "present market value". Without doubt, these changes dramatically raised the amount of money a farmer was permitted to borrow and in many cases the amount eligible for loan greatly exceeded the farmer's capacity to repay the loan. The 1971 act also allowed loans to be made for nonagricultural credit needs of farmers and ranchers.

From the beginning, the intent of Congress in establishing the Farm Credit System was to provide for ownership and control to be vested in the borrowers. The law granted to the borrowers complete ownership and control within the broad guidelines of the law. The System, in that sense, worked from the bottom to the top. The 1971 act, on the other hand, modified that to a certain extent by giving the district banks and the FCA more control over the local associations. After 1971, the policies of the Farm Credit System were established at the very top, the Federal Farm Credit Board and top Farm Credit System personnel. At the same time, however, the FCA relinquished some of its authority to examine the financial condition of district banks and associations and discontinued FCA control over strict appraisal rules on Federal land bank loans. Prior to the 1971 act, each district had an FCA appraiser who ensured the soundness of all Federal land bank loans.

In order to provide for more effective regulation and oversight by the FCA, Congress enacted legislation in 1985. Under the Farm Credit Act Amendments of 1985, the FCA became an arm's-length regulator similar to other Federal agencies. The powers of the FCA were strengthened by providing the authority to issue cease-and-desist orders to system institutions and power to issue regulations ensuring that borrowers are given full information about their loans. The 1985 act also created the Farm Credit System Capital Corporation which was to raise funds within the System and to be a central and ready source of financial assistance to borrowers, local associations, and district banks. It was the intent of Congress that the Farm Credit System rely first on its own resources before asking for a Federal infusion of money into the System. The Capital Corporation was established to accomplish that by drawing upon the cooperative nature of the System and assessing the healthier institutions in order to provide assistance to the weaker institutions. The 1985 act in addition stressed the importance of the local associations and it was the intent of Congress that no association be assessed to the point that its own financial viability was threatened.

Congress acted again in late 1986 by granting the authority for system institutions to use regulatory accounting principles [RAP], thereby allowing loan losses to be amortized over a number of years.

Despite the legislative action taken over the past 2 years, the System is still in trouble. The recent Farm Credit System's yearend statement points that out very clearly. While the report released on February 18, 1987, indicated lower losses than many earlier predictions, the impact of the $1.9 billion loss is severe. The system had $1.4 billion of surplus remaining at yearend, however, over $1.0 billion of this amount is held by various associations, not the banks. The recent ruling in Springfield, and various other court cases, are casting increasing doubt on the System's ability to move its surplus to where it is most needed and calls into question the cooperative nature of the System.

For the second consecutive year, loan volume declined by more than $12 billion, leaving the System with gross loans outstanding of $54.8 billion at yearend. Of this amount, $7.1 billion are nonaccrual loans and an additional $5.7 billion are considered "other high risk". Thus, only 77 percent of the System's loan portfolio is currently not considered to be at risk. The relative increase in the share of nonaccrual loans as a proportion of total assets, in conjunction with increases in other nonearning assets, including acquired property, is weakening the System's ability to generate sufficient interest income to cover its operating expenses.

This problem is compounded by the significant proportion of high coupon bonds remaining in the portfolio. The average cost of System debt remained above 10 percent in 1986 despite the major decline in interest rates associated with new borrowings. Competitive pressure on the demand side is also squeezing interest earnings. As a consequence, net interest margins have been falling from quarter to quarter. For the last quarter of 1986, the net interest margin was $185 million on earnings of approximately $1.6 billion. Any further deterioration of interest earned or any increase in interest paid could lead to negative margins. Even with margins at current levels, earnings are inadequate to cover operating expenses, irrespective of the need to set aside additional provisions for loan losses.

The System has dramatically increased its holdings of cash and investment securities. This imposes a significant cost in the sense that investment earnings are lower than would be earned on loans to farmers. Further, the diversion of assets into cash and securities does little in a direct sense for the primary goal of the Farm Credit System making loans to farmers.

The continued decline in the quality of the System's loan portfolio and the erosion of its surplus leads to the question of capital impairment. Primary risk capital, consisting of surplus and the allowance for losses is at $5.1 billion which is 40 percent of nonaccrual and "other high risk" loans. Including capital stock, the total risk capital is $9.3 billion, raising the ratio of risk capital to total high risk loans to 73 percent.

In addition, to aggregate financial accounts, the funding corporation report illustrates that differences in financial condition among districts result in certain banks being in far worse shape than the aggregate statistics suggest. For example, 5 of 12 Federal land bank's had negative net interest income. Further, seven Federal land banks and one production credit association required the use of regulatory accounting principles [RAP] to prevent impairment of borrower stock.

These factor suggest that the recent court decision in favor of Springfield and Texas and other court cases which impede the ability of the System to move its remaining resources, at least in the short run, may complicate efforts to keep individual institutions viable. While RAP accounting provides short-term relief, it could very well be at the cost of mortgaging future earnings. For institutions that have little likelihood of an imminent return to profitability, the benefits of RAP are illusory. The inability of the Capital Corporation to obtain funds means it is unable to completely fulfill its mandate of assisting banks and associations in financial difficulty.

The future for the Farm Credit System consequently does not look very good. Price Waterhouse & Co. issued a qualified audit opinion on the basis of not being able to determine how the System can remain viable in the future. In the near future, it appears that we can expect higher charge-offs as nonaccrual loans are liquidated and there is little prospect for increasing loan demand. Continued pressure to reduce rates on loans and accumulated deferred obligations from the use of RAP will lower earnings even if the quality of the loan portfolio stabilizes. As a result, Federal assistance appears likely to be needed soon.

It is from this background, bleak as it is, that we must begin the task of drafting legislation to provide this Federal assistance. As I have stated, it would be imprudent to merely provide financial assistance without providing a long-term remedy to the problems. The leadership in the Senate is prepared to move very quickly to consider this legislation once it is reported by the committee.

I want to thank all the witnesses for their willingness to appear before this subcommittee and for their cooperation as we begin our task.

I am pleased that I have several of my colleagues here this morning. As I said, others will be coming in as the hearings move on. We are going to be hearing this morning from some that give us a historic perspective as well as comments from the various groups in the agricultural sector. This afternoon we will hear principally from those who are charged with responsibility for operating the System.

We do face a serious problem. As I said, we intend to deal with it with dispatch, get the facts as best we can, and then move forward, and we are assured that this item will be placed on the agenda for action by the full Senate as soon as this committee acts. The Majority Leader is telling me that if we had a proposal out right now, he would put it on the schedule tomorrow. So, this committee is going to be given every bit of cooperation in moving a legislative solution as quickly as possible once we complete our own deliberations.

Senator Lugar, do you have an opening statement?

Senator LUGAR. No, Mr. Chairman. I appreciate your comments in setting forth some very basic questions, but I look forward to hearing the testimony.

Senator BOREN. Thank you very much. Senator Melcher.

STATEMENT OF HON. JOHN MELCHER, A U.S. SENATOR FROM MONTANA

Senator MELCHER. Well, Mr. Chairman, I feel the urgency as strongly as you do, and as strongly as the Majority Leader does for prompt action by this committee. I think perhaps the point is this, that far too often, and perhaps it is missed by the Farm Credit Administration, that the System is after all a cooperative system where the borrowers actually own the System. That is both its strength and currently its weakness because borrowers that are looking at the rates of interest that must be charged by the Federal land bank or the Production Credit Association have to weigh in their own financial and economic interests whether they want to repay their membership by borrowing money from the System.

The interest rates are then higher, and the requirement of purchase of stock is an expense. So those borrowers that find that in their best interest they should be getting their sources of credit from other institutions, whether it is a commercial bank or an insurance company or what have you, are leaving the System and that weakens it.

You are losing good, strong, financially strong borrowers, and that weakens the System. So I think the real question is how to get the interest rates down for both the Production Credit Associations, and the Federal land bank.

I have for over a year advocated that the Federal Reserve be the source of providing the $10 to $14 billion at very low cost money, somewhere around 5 percent interest, to offset the higher price, the bonds that the System owns with high interest rates. Whether or not that is the best way, the best way in my judgment, the most proper way of solving it, but whether it is the best way is up to the committee to make recommendations to the Senate.

The other alternatives, of course, are federally guaranteed bonds, or a combination of federally guaranteed bonds and tax-exempt bonds so the interest rates can be lowered on those bonds. But without some action which positively reduces the rate of interest for borrowers in the Federal land bank or the PCA's, without that reduction in interest rates, we are going to continue to see the rapid demise of the Farm Credit System.

I believe that is counterproductive for American agriculture and for the general economy of this country. I think we need the Farm Credit System, and I think we must take positive, determinative action here in this committee within a matter of days of forging together a bill that will provide lower rates of interest. If we want to make a difference in either one of the two I have suggested, I am certainly open to it.

But to fail to act to get the interest rates down to a competitive rate will mean that we are just driving another nail in the coffin in the Farm Credit System. Our patchwork, Band-Aid stuff over the last 2 years has not worked. Continuation of that policy, or that type of action, by Congress will only assure that we are sitting by letting the System go into total collapse. Thank you, Mr. Chairman.

Senator Boren. Thank you very much, Senator Melcher. I certainly agree with your comments. Repeated Band-Aids obviously have not solved the problem. We continue to have shrinkage of loan volume. We continue to have higher interest rates than are prevailing with competing lenders, and we also continue to have losses. So, something must be done in a comprehensive way to put the System back on track.

Senator Cochran, do you have any opening remarks that you would like to make?

STATEMENT OF HON. THAD COCHRAN, A U.S. SENATOR FROM MISSISSIPPI

Senator COCHRAN. Mr. Chairman, let me commend you for scheduling this hearing and for inviting the witnesses you have on the agenda today to testify before the committee. I think this indicates the depth of concern that exists here in this committee and in the Congress for finding the right course to follow legislatively to help assure the survival of the Farm Credit System, and more than that, to help make sure that the credit that is available to ranchers and to farmers is fair, that the interest rates are competitively set, and that the System is on a firm financial basis, a sound basis.

I know that everybody realizes that this is a matter that has been looked at very carefully already by the Congress through the General Accounting Office review that was undertaken in September of 1986, and through the hearings that were held last year. On September 17, as a matter of fact, we had a very good hearing in this committee to examine the situation as it then existed in the Farm Credit System. One of the results, of course, was legislative action, the adoption of the Farm Credit Amendments of 1986, and that followed the changes in the Farm Credit Act of 1971 that were approved by the Agriculture Committee in the farm bill of 1985.

So, efforts have been made to develop a consensus here in the Congress for action. I am anxious to hear from witnesses as to their assessments of the changes that have already been made, in terms of giving more flexibility to local managers in the setting of interest rates, whether or not this is going to lead to better rates of interest for borrowers. I think that is the key question that we have to pose this morning.

Without taking up the time of witnesses, Mr. Chairman, let me again commend you for the leadership you are showing in this issue area. I think we are all ready to take whatever action is appropriate to help get the job done, and get this System moving in the right direction.

Senator BOREN. Thank you very much, Senator Cochran. Senator Bond, do you have any opening comments? And by the way, I don't know about the arrangement of the room. I am going to direct that these two sides be moved closer together. We are going to try to forge a bipartisan solution on the farm credit matter, and I think the first step we will take before the afternoon is to narrow the gulf between the Democratic and Republican sides of the table. There are some changes taking place here. But, this is a matter in which we are all going to pull together and work together to get something done. Mr. Bond.

STATEMENT OF HON. CHRISTOPHER S. "KIT" BOND, A U.S. SENATOR FROM MISSOURI

Senator BOND. Mr. Chairman, my sincere thanks to you and the ranking member and the other members of this subcommittee for allowing me to sit in. Although I am not formally on this subcommittee, I do have a very great interest in the problems of farm credit and I join with Senator Cochran and others in commending you for calling this hearing.

You have assembled an outstanding panel of witnesses. We are most anxious to hear from them. It is clear that there is a great crisis in agricultural credit generally, and in the Farm Credit System in particular. Without trying to find fault or point fingers at mistakes that were made in the past, we need to look for ways to resolve those problems in the future. In our area, the St. Louis land bank is one where there are problems with its capital. Under the regulatory accounting procedures adopted last year, $5 worth of a borrower's stock still may be worth $5 on paper, but under generally accepted accounting procedures, it is only worth about $3.97.

There are going to have to be remedies taken. The Congress did take a good look at the problem and proposed some solutions in the last few years to which, I understand, there have been judicial challenges as well as other questions raised.

I think this problem is going to be, and has to be, one of the first problems we deal with in this committee, and I thank you for the opportunity to participate and listen to the witnesses.

Senator **Boren**. We are very glad to have you as a participant in this hearing. Senator Bond and I had the privilege of serving together when we were both Governors, and he is very knowledgeable in the area of agricultural policy. We are very fortunate to have him on the committee and be a part of these deliberations.

Senator Boschwitz, the ranking member of the subcommittee, has joined us. I realize that there are those who, when they noted that I would chair this subcommittee and that Senator Boschwitz would be the ranking member, remembered other Boschwitz-Boren proposals, and are beginning to worry a little bit about whether there will be another Boschwitz-Boren proposal. But we look forward to working together on this committee. Do you have any opening comments you would like to make?

Senator **Boschwitz**. No, but under the circumstances I am a little nervous sitting so close to you. The others don't know how my side is going to interpret this. [Laughter.]

Senator **Boren**. We are going to move these tables closer together all the way around.

We will start with our first witness, and let me say that we are going to try to move with dispatch, and I would appreciate it if all of the witnesses would try to summarize their statements as much as possible. We are going to try to stay within 5 minutes on our opening comments from each witness so that we can ask questions. Some of the members of some of the panels have already indicated to me that they have planes to catch. Some have come in from other places. So, we are going to try, with no disrespect to the witnesses, to stay right on schedule and within the 5 minutes allotted. If you could summarize testimony and hit the highlights for us, that would be very much appreciated.

First, we have Wayne Rasmussen, an historian, who is going to give us some historic perspective on the System which I think is very important. All too often, we operate in a vacuum here in the Congress in terms of understanding how programs came into existence and what the reason for them was. Certainly, we can better understand where we need to go if we understand the history of the System.

Mr. Rasmussen is the senior scholar at the National Agricultural Library. Mr. Rasmussen, we are very privileged to have you this morning, and I will recognize you at this time.

STATEMENT OF WAYNE RASMUSSEN, AGRICULTURAL HISTORIAN

Mr. RASMUSSEN. Thank you, Mr. Chairman and members of the subcommittee. I am pleased to be here today to discuss the historical background of the Farm Credit System and its programs. I shall try to summarize what I have to say, and my full statement will be available to members of the committee and to their staffs.[1]

Throughout our colonial and national history, the frontier farmer found it difficult to secure credit. Money was usually scarce, prices low, and both interest rates and risks high. The situation became acute after the Civil War. The farmers' needs were even more acute in that the Federal Government was aiding financial and business interests by reducing the amount of money per capita in circulation.

Many farmers turned to the old Greenback movement, the Populist Party, or free silver as promising aid, but all failed in their attempts to get more money into circulation. Sensitive to the needs of the business community, the Government was indifferent to the farmers' financial problems.

The first governmental recognition of the farmers' credit needs came in 1908 when President Theodore Roosevelt's Country Life Commission called attention in its report to the lack of any adequate system of agricultural credit.

There were a number of committees appointed and all said that we should have some sort of a system. Action seemed assured when, in their 1912 conventions the Republican, Democratic, and Progressive parties pledged themselves to better credit facilities for the farmer. Action on the legislation was delayed by the need to reconcile three opposing views.

One plan called for the establishment of privately owned farm mortgage banks under the supervision of the Federal Government. Another was for the organization of a system based on cooperative principles, while the third plan was for the Federal Government to make direct loans to farmers.

It was not until July 17, 1916, that the Federal Farm Loan Act was passed and signed by the President. The compromise act permitted the establishment of both privately owned and cooperative farm mortgage banks.

The agricultural credit system was modeled upon the Federal Reserve System in its general outline as well as in many details. Corresponding to the Federal Reserve Board at the head of the Federal Reserve System was the Federal Farm Loan Board. The Federal land banks occupied a position analogous to that of the Federal Reserve Banks. There were other similarities as well.

Congress, in passing the original Federal Farm Loan Act in 1916, made it quite clear that it expected the Federal land banks and the Federal Land Bank Associations to become a cooperative credit system in which farmers would have the responsibility of organizing and operating their local associations, and in owning and in having a voice in running their district Federal land banks. That is, a decentralized system that in time could be controlled by the farmers themselves was established.

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[1] See p. 244 for the prepared statement of Mr. Rasmussen.

Congress provided the original capital for the Federal land banks with a provision for farmers to organize local associations. As farmers obtained long-term mortgage loans from the land banks, they were to invest 5 percent of their loans in the capital stock of their local associations, and thus the associations would become owned by the farmers.

The Federal land banks by making available amortized loans for periods as long as 20 to 40 years brought about fundamental changes in farm mortgage lending. They eliminated the need for high interest rates and renewal fees every 3 to 5 years. Other lenders gradually began to follow suit in order to compete.

In 1923, Congress authorized the organization of the 12 Federal intermediate credit banks to work alongside the Federal land banks. These banks were essentially to be wholesalers of credit, and only limited use was made of them up until 1933 because of the lack of retail outlets.

Useful as the land banks and intermediate banks were to individual farmers—and Senator Melcher, my father in Montana obtained the first loan from the Federal Land Bank of Spokane back in 1916—they were unable to stem the ravages of the continuing farm depression of the 1920's.

Then when the Great Depression hit the Nation in 1929, farm prices already down, went down further and faster than anything else. The Federal land banks were dependent upon installment payments on their loans to pay interest on their bonds, but many farmers were unable to make payments.

The situation made it almost impossible for the banks to sell bonds so loan funds dried up. In 1932, the banks made loans totaling only $28 million to 7,000 farmers in spite of the fact that many more were clamoring for money.

The Depression deepened, and it was, of course, stimulated by the continuing farm depression. Then beginning in 1933, a number of rapid actions were taken by President Franklin D. Roosevelt and Congress to solve the desperate credit needs that faced the American farmers. By 1933, farmers' incomes were approaching the vanishing point. Lenders were foreclosing mortgages by the thousands.

In fact, in the Midwest, we even had some violence with the Farm Holiday Association. Congress made provisions for emergency credit by passing the Emergency Farm Mortgage Act of May 12, 1933. This act provided a $200 million fund to the land bank commissioner to make both first and second mortgage loans to refinance farmers' debts as a supplement to financing by the Federal land banks. These loans were handled through the existing Federal Land Bank System. The Emergency Farm Mortgage Act also provided for a temporary reduction of interest rates in Federal land bank loans.

The land banks were reimbursed from the U.S. Treasury for the difference between the interest rates the farmers contracted to pay and the emergency rate established by the Congress. The establishment of the Farm Credit Administration by Executive order on May 27, 1933, was followed by the Farm Credit Act of June 13, 1933. There were then a series of acts which I detailed in the paper but will not take the time to discuss now. In general, the Federal Government, Congress particularly, was appropriating emergency money to the Farm Credit Administration to refinance farm loans.

From May 1933 to the end of 1935, the Land Bank System on its own behalf and for the Federal Farm Mortgage Corporation made 726,000 loans totaling nearly $2 billion. By the end of 1935, the Federal Land Bank System held 48 percent of the total farm mortgage debt of the country.

The refinancing program cut farmers' interest bills by about $38 million a year. In addition, many creditors agreed to scale down farmers' debts to them so farmers might be eligible for mortgage loans and thus enable creditors to get cash.

These scale-downs totaled an estimated $200 million. In 1939, the Farm Credit Administration was transferred from its independent agency status to become a part of the U.S. Department of Agriculture. This was a very controversial move, and it caused some problems for the Farm Credit Administration, for the Department and for other people.

In 1953, the Farm Credit Administration again became an independent agency. In 1971, Congress consolidated all previous laws regarding the Farm Credit System into a new Farm Credit Act. The act specified that Federal land bank loans could not exceed 80 percent of the appraised value of the real estate offer for security. Prior to 1971, the banks could lend only up to 65 percent of the normal agricultural value of real estate.

Under this new legislation, the component parts of the Farm Credit System were able to pool capital, share losses, exchange loans, participate in loan syndications, and continue to gather funds nationwide through the sale of bonds and other debt instruments.

For many years, the Farm Credit System was regarded as one of the most stable segments of the financial community. During the 1970's when farmers were generally prosperous, the system increased its share of lending to the agricultural sector from 24 percent of total agricultural loans made in 1971 to 33 percent in 1981.

However, as land prices began to fall in 1982, the security backing many of the loans fell to below the amount of the loans. That is our situation, of course, today. Too, increasing interest rates caused problems. Although legislation has set special interest rates at various times in the past for the System, legislation in effect for many years provided that the interest rates charges should not exceed the interest rate on the last series of farm loan bonds issued by the bank making the loan plus 1 percent.

This meant that in a period of rapidly rising interest rates, the Farm Credit land banks could keep up with the increasing costs of money. However, in recent years, the System priced its interest rates according to the average rate it paid on its total portfolio of bonds and notes outstanding plus 1 percent. This helped farmers in times of inflation, but was a problem for the System.

The 1985 amendments to the Farm Credit Act changed the organizational structure of the overseeing agency, the Farm Credit Administration, by replacing the 13 person Federal Farm Credit Board with a 3 person Presidentially appointed board of directors. The administration's regulatory powers over the System's institutions was increased. The amendments brought about major changes in that authority over the entire System was more centralized as contrasted with the original objective of setting up a decentralized System in which farmer members would have a major voice. The amendments also made it clear that as Congress should direct, the U.S. Treasury would be a lender of last resort to the System to ensure that it would not have to default on its outstanding bonds and notes.

The Farm Credit System today is responsible for providing the credit needed for keeping American farmers in operation insofar as that can be done. But the System is dependent upon farmers having an opportunity to make a living and to pay off their debts.

The Farm Credit System like farmers has been caught up in a very deep downturn in a cycle of agricultural prices and returns. But because farming is cyclical in nature, we can hope that the cycle has bottomed out and is starting an upturn. It is possible, however, that the System may have to rely upon funds from the U.S. Treasury to stay solvent until the cycle moves further along the upside.

If that happens, then the Farm Credit System will have the opportunity to do what it did in the 1930's. With Federal funds, it can help farmers survive a difficult period and thus contribute to the betterment of American life. Thank you very much.

Senator **Boren**. Thank you very much, Mr. Rasmussen.

I think what we would like to do at this point is to allow Senator Grassley, who has come in and has to go on to another meeting, to make his statement and then we will return, if you don't mind, then, to questions to you based upon the statement which you have just made to you and for which we are very grateful.

Senator Grassley, if you would just join Mr. Rasmussen here and make your statement to the committee at this time. We are very glad that you have joined us this morning. Senator Grassley is one who has exerted great influence on agricultural policy. He has consistently showed and demonstrated a deep concern for the wellbeing of the farming community of this Nation. I have the privilege of serving with him also on the Finance Committee where more than any other Member he has consistently raised the concerns of agriculture as we have made decisions on tax policy and trade policy and other decisions in that arena as well.

So Senator Grassley, we welcome you to this hearing this morning.

Senator **Boschwitz**. If I may add a word of welcome, Mr. Chairman. As you know, Senator Grassley is a farmer, and so has a better understanding. Maybe he is even a borrower from the Farm Credit System.

Senator **Grassley**. I am.

Senator **Boschwitz**. Are you? And I presume he is current.

Senator **Grassley**. It happens that I am. But you ought not to assume that. [Laughter.]

Senator **Boschwitz**. I know that on many weekends his form of relaxation is to go home and farm so that he has a great sense of, as you pointed out, what the needs and what the concerns of people in agriculture, what those concerns are because he certainly is among them.

Senator **Boren**. Thank you. Senator Grassley.

STATEMENT OF HON. CHARLES GRASSLEY, A U.S. SENATOR FROM IOWA

Senator **Grassley**. Thanks to both of my colleagues. First of all, Mr. Chairman, I have a statement I would like to have put in the record.[1]

Senator **Boren**. Without objection, it will be entered.

Senator **Grassley**. I am not sure you can summarize a 5 page statement. It might even be better to read it, but I know that you are under a tight schedule so I want to try to do that. And that is along this line, Mr. Chairman. Number one, why should I come to tell you, as a chairman and colleagues, what I probably have said 10 times for the official record and hundreds of times for the unofficial record over the last 18 months that this has been a problem in the Farm Credit System.

I come to this meeting because this is the first forum I know of where there has been, for the official record, a look at the historical purpose of the Farm Credit System. I believe that is the basis of this hearing, to look back at the historical basis of the System and think in terms of policy based upon that.

We ought to be reminded that the Farm Credit System was started to serve farmers, to be controlled by farmers, and to be owned by farmers. I think we lost that in our last debate in December of 1985 when we considered legislation on the floor. Second, I am saying this in the context at a time now where there is a certainty that Congress is going to be dealing with this issue. I think we all accept that. There are a lot of points that should be made about stockholders' rights and about where the borrower ought to come in the line of priority of being helped by the System. I don't believe a farmer ought to be thrown out of the System and a new person come in and take over if that can be avoided.

We talked about those things in the last debate, but we were always told, as I recall, Frank Naylor speaking for the administration, and he was the one we were dealing with, that I hear what you are saying, Chuck, but—you know. We had a very good case for what we were trying to make is what that quote really says, but that we really didn't have to do that now, or that down the road the situation would improve so we really didn't have to deal with those problems congressionally and through statute.

The fact is there has not been a thing that has improved, and we have an opportunity now to deal with those things with this issue coming up again, and I want to urge my colleagues on this committee not to miss that opportunity that we missed because everybody could hear what we were saying, but there was not any need to deal with it statutorily. Or that the System was going to get better, or we were under limited debate, and we did not have time to deal with it.

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[1] See p. 243 for the prepared statement of Senator Grassley.

Well, you are holding this hearing, Mr. Chairman, in an environment where there is time to deal with these problems, and you are looking at it historically to see what the purpose was to serve, and you are going to find that the purpose now being served and the people meant to be served are not being served the way they should be.

We have an opportunity to deal with it now, and we do not want to either miss this from an historical perspective, and we do not want to miss it from a practical perspective of an opportunity to deal with it. So all those issues that came up in December of 1985 or November of 1985 when we were told we do not have time to deal with them, we now have an opportunity and time to deal with them.

They basically deal with, number one, stockholders' rights; number two, who is going to control the System; is the local board going to make any difference; are those decisions going to be made in Omaha, Nebraska or Cedar Falls, Iowa? And is it serving its people? For instance, is it right for the Farm Credit System to push a stockholder-borrower off the land because he cannot pay 12¾ percent interest, and is it right to bring on a person who is paying 4.9 percent as the ad of "Buy North Dakota" said?

I think when we look at it historically, we are going to find that there is no reason for deviating from the original purpose because the economic situation in the 1980's is just as bad as it was in the 1930's, when it was set up to be controlled by farmers. Is there any reason for having it controlled by anybody else? Should the borrower be the main concern of the System, or should the System itself be that main concern?

Now, I ought to feel a little nervous sitting beside an agricultural historian, and maybe he'll say, well, Grassley, you have really misinterpreted what the purpose of the System is. I hope I have not. But even if I have, let me say that all those people for decades that have been members out there, or for new borrowers, they seem to understand the purpose of the System in the context that I have stated. So whether it is perception or not, or fact or not, I think perception has to rule our debate if we are going to be responsive to the grassroots' concerns of the System out there.

So, in the context of at least those three things, not meaning that there are not other things that ought to be addressed, but who controls the System, does the System serve the borrower first, and are we going to protect stockholders' rights as well as that investment, at least within those three things we should not miss an opportunity this time to protect our farmers' interests in a statutory fashion that because of time or because somebody said I hear what you are saying, Chuck, but we didn't get around to it last time. There can be no excuse for a missed opportunity this time. That is more or less what is said in five pages. I am sorry it took me 10 pages to say it. [Laughter.]

Senator Boren. Senator Grassley, I think you said it so well that I would not care if it did take 10 pages for you to say it. You have focused us exactly on the question at hand. It is very hard for me to understand how in the world any policy could be called fair when we are forcing people off the land who are member borrowers, and as you say, paying 12 percent, or 10 or 12 percent, and then turning around and advertising that we will put new people right back on the land at half the interest rate. And, we will get into that in questions in terms of the history with Mr. Rasmussen.

I think one of the purposes from the beginning was to avoid the wide differential in interest rates available to farm borrowers in the first place and to keep farmers in business. But I think you have stated the issues extremely well, and in asking the question of why should we respond so differently now than we responded in the crisis period of the 1930's when we are facing again a period very, very similar in terms of the kinds of distress that agriculture is facing. Why should we not respond in the way that we responded then and the way that worked? I think you raise another excellent question that we should address in this committee, and one which we are going to take the time to address as we look at these proposals.

Senator Daschle has also joined us. We are very glad to have you with us this morning. Any comments you would like to make before we open up for questions to Senator Grassley.

Senator **Daschle**. Thank you, Mr. Chairman.

Senator **Boren**. Let me ask you, Senator Grassley. I know you have to move right on. Senator McConnell, I see, has joined us too.

Senator **McConnell**. Mr. Chairman, like Senator Daschle, I am not going to delay the proceedings. I do have a prepared statement which I would like to have inserted in the record.[1]

Senator **Boren**. It will be received in the record.

Senator **McConnell**. I look forward to hearing from Mr. Rasmussen.

Senator **Boren**. Any questions? We won't detain Senator Grassley. But are there any burning questions that the committee members would like to ask?

Senator **Boschwitz**. Mr. Chairman, I would like to state that I know in our district the lower interest rates are being offered. I would just point out for the record that a 50 percent downpayment is required, and that the land has to be acquired, I believe, at 20 percent over the market value to get that kind of interest rate, and that there is a first refusal on the part of the farmer involved.

I do not defend that procedure at the moment, though it seems to be clearing up some of the problems. I know that the St. Paul District is seeking to negotiate with its lenders so that it is not just an either/or type of situation. One of the things, Senator Grassley, that is now becoming quite an issue is the stock of the borrowers, the devaluation of the stock, and the possibility of the farmer losing some of that stock.

I wonder if you would comment on what you see as the results of those kind of actions by the Farm Credit Administration.

Senator **Grassley**. Let me say that it would just be another nail in the coffin of respectability for the System, and I can say this, I believe, categorically because it has been 1959 since I started farming.

I think that the Farm Credit System has gone from the most respected institution in agriculture to the least respected today. This is just going to lead to further deterioration of it. It is going to very definitely hurt the balance sheet of a lot of farmers that are in trouble otherwise as far as showing the necessary equity to their loan.

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[1] See p. 242 for the prepared statement of Senator McConnell.

So, it has both a practical as well as less measurable impact as well on the entire System. Mr. Chairman, I want to note that as a member of the Agriculture Subcommittee of Appropriations, I would look forward to helping on this issue with you in your position as chairman of this subcommittee.

Senator BOREN. I appreciate that very much, and of course, that may well become necessary as we really determine the dimensions of the problems that we are facing and determine whether or not there is a need for an additional infusion into the System. Again, I want to thank you for appearing this morning and for your excellent statement.

Senator GRASSLEY. Let me say thank you for letting me interrupt you.

Mr. RASMUSSEN. You are a real historian, Senator Grassley.

Senator GRASSLEY. Tell it to my former professors. [Laughter.]

Senator BOREN. We appreciate the historic perspective that has been shed by both of you in your statements, and we will return at this time again to Mr. Rasmussen. We do thank you for allowing Senator Grassley to step in as he had an unusually busy schedule this morning. Let me go back to your statement about the original purposes, as we look back to the creation of the System in 1916. I gather that one of the purposes was to provide long-term mortgages for farmers so that they would be able to pay out these mortgages over a reasonable period of time and be able to sustain their farming operations.

Also that one of the problems in the beginning was the wide differential in interest rates that were available to farmers in various parts of the country and various circumstances. Was one of the purposes of the original System to try to provide not only long-term credit but also credit at some equality of interest rates?

Mr. RASMUSSEN. That was certainly true. The commercial banking system at that time did not seem to be particularly interested in long-term loans to farmers. In fact, there were very few such loans available. Three to five years was the average term in the early 1900's for farm mortgage loans. And with that short period of time interest rates were high. They were probably twice as high at the time the land banks were set up, twice as high for farmers as they were for the commercial side of our economy.

Farming, of course, was more risky. There is just no doubt about that. It always has been. Nevertheless, there seemed to be a certain unfairness in a system that could not provide for the basic industry of the United States. This is what the Country Life Commission of 1908 said in its report. It is what a number of other study groups appointed by first President Roosevelt, President Taft, and President Wilson all said in regard to the problem.

So the goal was to establish long-term loans at moderate interest rates, at interest rates that would be certainly no higher than commercial long-term loans and hopefully with a cooperative system could be brought down even lower.

Senator BOREN. What about the equality of rates between farmers? Was it assumed that the System would provide credit to farmers on a reasonably equalized interest rate basis?

Mr. RASMUSSEN. Yes, it was. The whole System was set up as a cooperative, basically a cooperative System so that there would be an equality as between farmers. That you would not charge one member of your System 7 percent and another member 4 percent. It was pretty much across the board that there would be some interest rate, 4, 5, or 6 percent at that time.

Senator BOREN. Equally applied then to all the member borrowers.

Mr. RASMUSSEN. Equally applied across the board, yes.

Senator BOREN. Let me go back to the time, and Senator Grassley talked about the fact that obviously we went through a period of time in the thirties in which we faced circumstances not very dissmiliar to what we are facing now. We had terrible cash flow problems for farmers. We had depressed incomes, and we had, of course, deflation of land values, deflation of the assets on which farmers were securing credit.

How did the Government during the farm depression of the thirties respond to the financial strains that were placed upon the System? And then I would ask you if you think a similar approach would be workable today?

Mr. RASMUSSEN. The System was under very, very severe stress by the early 1930's. It was not particularly the fault of the System. It was the fault of the continuing farm depression which really helped drag the whole Nation into the Great Depression. But something had to be done. In Iowa in Senator Grassley's State, a group of farmers went and pulled a judge off of a bench where he was hearing foreclosure proceedings, took him out and threatened to hang him unless he would swear to never again sign a foreclosure proceeding.

The judge stood by his guns and the farmers let him go. They didn't hang him, but nevertheless that showed the kind of thing that was going on.

Senator BOSCHWITZ. May I just ask a question?

Mr. RASMUSSEN. Yes.

Senator BOSCHWITZ. Not to interrupt, Senator Boren, but, what was the size of the Farm Credit System relative to overall farm lending? Was it about the same proportion as it is today?

Mr. RASMUSSEN. No, it was substantially smaller at the time. At that time, it had about a fourth of farm loans.

Senator BOREN. We have declined now in recent days—of course we have been much higher—but I understand we are down to somewhere in the neighborhood of a third now.

Mr. RASMUSSEN. Yes, well——

Senator BOREN. We were up much higher at one time.

Mr. RASMUSSEN. Yes. At the time the Farm Credit Administration was established, land banks had about a fourth of the farm mortgage paper. By the mid-1930's, they had about one-half.

Senator BOREN. So it grew very rapidly.

Mr. RASMUSSEN. It grew very rapidly, and it grew very rapidly in this way. Congress appropriated emergency funds. They appropriated emergency funds to help overcome the Great Depression in cities and in the country as well. It sounded like a lot of money, but the money that was being appropriated was less than the money being appropriated to relieve distress in the cities at the time.

Under the regulations, then, any creditor who wanted to foreclose had to work with a local committee with his debtor to see if they could reach some accommodation. When they could not, then the Farm Credit Bank, Farm Credit System, might take over that loan. But ordinarily they tried to reach some accommodation first. Even if they reached some accommodation and the bank was pressed for money, then the Federal land bank would buy that paper using the money that had been appropriated as an emergency appropriation by the Congress.

Senator **Boren**. So the Congress, rather than following the posture of raising interest rates, transferring funds within the System, and continuing with the foreclosure policy, appropriated an injection of capital into the System at that period of time?

Mr. **Rasmussen**. That is absolutely correct. In addition to just appropriating the capital, some of the funds were available if interest rates were reduced. Say in the private area, if interest rates were cut, then the System could reimburse that private bank for the difference in interest rates if they thought it was necessary.

They even went that far in trying to save the family farmer at that time.

Senator **Boren**. That is right. And as a result of that, was that appropriation, in essence, finally paid back?

Mr. **Rasmussen**. Every penny of it was paid back.

Senator **Boren**. When did the final payback occur?

Mr. **Rasmussen**. If I remember correctly, it was in the early 1960's.

Senator **Boren**. When you look at, and again from your historic perspective, when you compare what is done now with what was done then which to enable us to keep the interest rates on a stable, relatively low basis for farmers, enabled us to not put pressure on the local associations because of capital shortages and push them into foreclosures, do you think it would be more appropriate for us to look at a similar approach to that used in the 1930's?

Mr. **Rasmussen**. A historian should never forecast or make recommendations, but I'll step aside from being a historian and say my studies of the Farm Credit System suggest to me that we should take a very close look at the actions that were taken by the Congress in the 1930's and give very serious consideration to going through some such action.

I know that the Farm Credit System today is proud of owning its own system, or not owing any Federal money, but nevertheless, the Farm Credit System was set up to serve the American farmer. The Farm Credit System was not set up to be a self-serving system.

Senator **Boren**. Let me ask one last question, and then I will not impose on my colleagues any longer. There were changes, of course, made in 1971 principally, and along the way since the System was first set up, and I understand when the System was first set up, loans to farmers were limited to 50 percent of the value of their holdings, and the land holdings were appraised based upon their agricultural use value.

Along the way, and particularly in the 1970's, that was changed to allow for up to 85 percent loan against the market value which, of course, was a much higher value than the agricultural production value. I was talking recently to some people about the state of British agriculture, and they said, well, one of the reasons why British agriculture was in a position to perhaps survive more of the stresses and strains that all of us are now going to be going through than American agriculture is because they were so much less highly leveraged and that the amount of debt per farm unit compared to normal income was so much lower in many other countries than the debt burden for farm unit is in the United States.

Why were these changes made, and do you think they contributed to our highly leveraged situation today?

Mr. **Rasmussen**. Well, just the last question. Of course, they contributed to our highly leveraged system today, and they were made because the period of the 1970's was the period when surpluses had disappeared. We were going into a period of inflation in the Nation. Farm prices were going up even faster than prices for everything else. The Secretary of Agriculture, most of the agricultural economists in the country and most of us in the Department of Agriculture, and most people in the land-grant colleges were saying we are reaching a new level of stability. Prices are going to stay high. Demand is going to stay high. Now is the time for the farmer to get out there and expand. Now is the time to buy that extra quarter section or to buy that new four-wheel drive tractor or whatever it is.

And every financial institution of which I am aware was out there selling the farmer money based on these very, very optimistic prognostications. They were good for about a decade during the seventies, but they got the farmer into the situation in which he is today.

Senator **Boren**. Senator Boschwitz, any questions?

Senator **Boschwitz**. That certainly is a fair appraisal of things. I want to ask you to repeat what was done in the thirties. Times do change in agriculture. In addition to the folks out there hawking money, interest rates were very low in real terms which was reversed in the 1980's, and interest rates became very high in real terms.

Interest rates in the Farm Credit System were even sometimes less than the rate of inflation so that it was very appealing to borrow, particularly when you were receiving all this advice from the "wisemen" who allegedly knew what was going to happen. It is a lesson that we should not overlook.

But would you repeat again quite precisely what the Federal Government did in the 1930's, and what the amount of money was involved? You skipped over it, and you said the figure of $38 million, and it was not clear to me. Would you please rather precisely say what was done in the 1930's and how much it cost? What did it cost, for instance, to go from a quarter of the farm loans to half of the farm loans at that time?

Mr. **Rasmussen**. The first provision for emergency credit was under the Emergency Farm Mortgage Act of 1933, and this provided a $200 million fund to the Land Bank Commissioner.

Senator **Boschwitz**. Are you reading from your statement?

Mr. **Rasmussen**. This is on page six of the statement. But I wanted to go ahead and say, and this is something I did not get into this statement, but this was followed very shortly by a $1.1 billion allocation from emergency funds to the new Farm Credit System. So that by the mid-1930's, the Federal Government probably had something in the nature of $1.5 billion in the System.

Of course, that does not seem like that much today, but back then that was real money.

Senator **Boschwitz**. I think we covered it cost $1.5 billion to go from a quarter to half, or the $1.5 billion included the first quarter as well?

Mr. **Rasmussen**. Well, it cost about that much to make the change, yes. Now, there was a lot of refinancing. I would have to go back and do a little studying to be able to answer that precisely. I am sorry to say I just don't know that exactly.

Senator **Boschwitz**. What was the rate of interest? That may not be a relevant question because the rate of interest was so low at those times.

Mr. **Rasmussen**. It was generally around 4.5 or 5 percent.

Senator **Boschwitz**. That was high at that time.

Mr. **Rasmussen**. That was high, yes.

Senator **Boschwitz**. Surprisingly high.

Mr. **Rasmussen**. It was generally running about that.

Senator **Boschwitz**. Thank you, Mr. Chairman.

Mr. **Rasmussen**. Excuse me. There was one other thing I should add that Congress from time to time did pass laws providing for lower interest rates for particular kinds of loans for particular purposes at one time and another, 3 percent loans for some purposes.

Senator **Boschwitz**. Was this an appropriation that the Congress made to the Farm Credit System, or was this a loan that was made to the Farm Credit System that was paid back, as you said, in the early 1960's?

Mr. **Rasmussen**. A lot of the money was a loan that was paid back. The very first money came out of an emergency appropriation and was an appropriation. But nevertheless it was always regarded as a loan aside from the setting of expenses, operating expenses for the System.

Senator **Boren**. Was the loan made, however, principally from appropriated funds even though it was made as a loan? It would be paid back?

Mr. **Rasmussen**. It was made out of directly appropriated funds.

Senator **Boren**. So Congress appropriated the funds, but then appropriated it with the condition that it be paid back as a loan over a period of time?

Mr. **Rasmussen**. Yes.

Senator **Boren**. Senator Daschle, any questions?

Senator **Daschle**. Thank you, Mr. Chairman. First, I am sorry I missed your initial comments, Mr. Rasmussen, and you may have addressed this. In terms of severity, does the acute condition within which the System finds itself today have any parallel in the 50 years?

Mr. **Rasmussen**. Well, certainly the Land Bank System found itself in 1930, 1931, and 1932——

Senator **Daschle**. I should say other than at the time of creation?

Mr. **Rasmussen**. No, at that time we have never had that bad a situation. We had a depression in the mid-1950's that put a little pressure on the System but not enough that there was even any doubt about it being able to carry through. This is the first time that we have had a farm depression that is more or less parallel to that of the 1930's.

Senator **Daschle**. In the 1930's, there was a real dissimilarity in interest rates and in the availability of capital in PCA's and Federal land banks. The variance in interest rates was quite dramatic. Is that not correct.

Mr. **Rasmussen**. That is correct, yes.

Senator **Daschle**. That is also correct today. What analogous relationships can you draw from that comparison?

Mr. **Rasmussen**. Well, the only thing I could say along that line is that as the System became established with this tremendous infusion of Federal money that the interest rates tended to level out throughout the System.

Senator **Daschle**. So, in other words, you could associate the dramatic variances in interest rate with the severity of the situation within which the System found itself?

Mr. **Rasmussen**. Yes, I certainly would.

Senator **Daschle**. Would you go as far as to say there were rational bases for that variance in interest rates?

Mr. **Rasmussen**. Well, certainly. It was a lot more risky to loan money on my old home ranch in Montana at that time than it was to lend money to a dairy farmer in Vermont who had a sure market in New York City. So naturally enough, the interest rate on that Montana ranch would be higher.

Senator **Daschle**. As you consider the opposition which obviously exists today—as I traveled through North and South Dakota, Nebraska, and Iowa, one of the most consistent statements of frustration and virtually outrage were the ads which indicated one could "buy North Dakota for 4.9 percent," you know that is understandable. They oftentimes do write and say, but I have to pay 12.5 percent to buy my land back in South Dakota. What would your answer be to somebody like that?

Mr. **Rasmussen**. My answer would be that we should be refinancing 12 percent loans, and that we should be getting them down to current interest rates. I think that that was done with the land bank loans. A lot of those loans in the 1920's had been made at fairly high interest rates because of general prosperity at the time. They had to be refinanced at a lower interest rate, and that was what saved the American farmer in the 1930's.

Senator **Daschle**. And the refinance was paid for in large part through the appropriation we were addressing earlier?

Mr. **Rasmussen**. Exactly.

Senator **Daschle**. Let me ask one last question, and that relates to this trend toward centralization that we are developing here. As I understand it, there was a trend toward centralization 50 years ago, and then the whole System became decentralized with a great deal of local control. The local PCA's and Federal land banks had virtual autonomy when it came to much decisionmaking authority.

We are shifting back toward that centralized sort of system. How do you see that? First of all, do you think the situation warrants that centralization? Number two, what are the ramifications from an historical perspective for the loss of local control?

Mr. RASMUSSEN. Well, of course, Congress did make the change a couple of years ago, and certainly Congress at the time felt that that was a rational thing to do. However, it was totally contrary to the original goals of the establishment of the Farm Credit System. The Farm Credit System when it was established in 1933 was not to further centralize the land bank system. It was to further decentralize the land bank system.

The thought then was that the financial interests in the big cities were not simply interested and were not able to take care of farm interests out there in the country. If you were going to have the farmers' interests taken care of, you had to get some by the farmers. And the thought was that not only would the farmers have a say in the local organizations, but eventually with their purchase of stock and paying back the Federal money, the farmers themselves would own and operate the system on a decentralized basis.

Now whether or not that is applicable today, I think I would have to leave that up to you, Senator.

Senator DASCHLE. I would say it is not applicable today.

Mr. RASMUSSEN. That is my own feeling, too. But it is a real problem.

Senator DASCHLE. Thank you. I am sure I have used up my time, Mr. Chairman. Thank you.

Senator BOREN. Thank you, Senator Daschle. Senator McConnell.

Senator MCCONNELL. Thank you, Mr. Chairman. Most of us would not like to see the Farm Credit System become a quasi-public Farmers Home Administration. FmHA has long since shown its ineptness in managing loan portfolios. I was wondering, Mr. Rasmussen, what the historical relationship has been between the Farm Credit System and the Farmers Home Administration, particularly back in the thirties?

Mr. RASMUSSEN. The Farm Credit System was basically set up to save what today we would call the mid-level, or the commercial family, farmer. It was not set up to help the tenant farmer become an owner. It was not set up to carry on an educational process with some poor farmer in some poor area. It was not to move a farmer from some poor area to another. First, the resettlement; then farm security; then today our Farmers Home Administration was set up, as they said at the time, to help the poorest of the poor, to help some of the tenants who were losing their places in some areas to become land owners. And there were a great many very expensive and some very inept plans set up to do this.

But the whole concept of the two systems was different. The one was to try to bring some very low level farmers up to a mid-level position, while the Farm Credit Administration was there to preserve what had been the backbone of our American economy, the mid-level family farm.

Senator MCCONNELL. You may have covered this earlier, but has the Farm Credit System in the past had to deal with widely fluctuating interest rates that we have had for the last 8 years?

Mr. RASMUSSEN. Not nearly as much. The idea at any given time up until recent years that you had to take account of what that land could produce at current prices was kind of a leveling influence there. It kept the loans from going up as the prices of land went up and as interest rates went up. Of course, that was changed when we moved from the 60 to the 85 percent of value.

Senator MCCONNELL. Senator Boren, in his opening statement, touched on an issue in this debate which may become important. I am wondering if the System has considered diversifying its loan portfolio to protect itself against these kind of wide swings in farm income?

Mr. RASMUSSEN. I am sorry. I just do not know.

Senator BOREN. Well, the System was never set up, though, really to be a diversified lending institution. It was really set up strictly to service farmer members; was it not?

Mr. RASMUSSEN. That is correct. It was set up to be operated by farmers for farmers. That was it.

Senator BOREN. So it was not ever really anticipated that it would invest in shopping centers or whatever?

Mr. RASMUSSEN. No, not in the beginning. It certainly never was. When it was set up, it was a farm system.

Senator BOREN. Thank you very much, Senator McConnell. Again, Mr. Rasmussen, thank you very much for the perspective that you have provided for us this morning. It is very helpful to us as we begin these deliberations.

Mr. RASMUSSEN. Thank you very much.

Senator BOREN. Thank you. We will move on to our next panel now. And it is composed of Dean Kleckner, the president of the American Farm Bureau Federation; David Senter, the national director of the American Agriculture Movement; Mr. Jack Kelsey, representing the National Farmers Union, and I might mention certainly a contributing factor to his wisdom and understanding is that he is also president of the Oklahoma Farmers Union; and Mr. Grant Buntrock, assistant director, Washington Office of the National Farmers Organization.

Gentlemen, we are very privileged to have all of you here this morning. I understand that Mr. Kleckner has to leave here to catch a plane in about 15 minutes or so.

Mr. KLECKNER. Twenty minutes.

Senator BOREN. So without showing any favoritism among farm organizations, I hope that your colleagues will understand if I ask you to go ahead and make your opening statement, first, and I am sure that your friends here at the table will take good care of you after you have departed for the airport.

We will begin with your statement, and then if members of the committee have questions they would like to address to you personally, we will allow them to go ahead and do that. Then we will go ahead with the other three members of the panel. Mr. Kleckner, happy to have you.

STATEMENT OF DEAN KLECKNER, PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. KLECKNER. Thank you, Senator. I appreciate that. I have an agreement with the airlines. If I am late, they do not wait.

Senator BOREN. I understand.

Mr. KLECKNER. I am Dean Kleckner, President of the American Farm Bureau, and I do farm in northern Iowa. I am going to summarize from my statement and try to be within the 5 minutes or thereabouts.[1]

We have concentrated a lot of time and effort in Farm Bureau in the last 2 or 3 years in this area of farm credit, and you are to be complimented. I have agreed with I think everything I have heard all of you say this morning. You are right on target, and as is my own Senator Grassley who testified.

In the fourth paragraph, I say, Mr. Chairman, as we see it the System has a number of financial problems, and we list five. They are: borrower flight; high cost of money; loss of income due to nonaccruing loans; losses on loan liquidations; and the high cost of doing business. We think they could have handled one or two of those, but they just have not been able to handle all of those, and we do not think they will be able to do it by focusing on just one or two.

The problems in a bit more detail. On borrower flight: it has gone down now in the loan volume from $79 billion, almost $80 billion, to $58 billion in 2 years. They lost over a quarter of their loan volume in 2 years.

The high cost of money: they have now $29 billion worth of bonds that have rates of 10 percent or more, and they average 12 percent. Those that average under 10 percent are at an average of 7¼. And when you compare those 12 percent bonds with ones recently sold by the System at 6 or 7 percent, it is easy to see why the System is in trouble today.

It sounds like Monday-morning quarterbacking, but we believe they made some poor management decisions, and I call your attention to two. Those are those high cost bonds. They issued noncallable bonds rather than callable bonds to save a little bit of interest and that decision is really costing them today.

The second decision that they made that we think was not good was the policy of average pricing the farmers. As long as interest rates continued to increase, that policy worked and it looked good. But we believe that marginal pricing and being competitive rather than below competition would have proven to be a better strategy, and they should have known that interest rates do not always go up. They would eventually begin to fall, and now they and we, and I am a borrower also of the Farm Credit System in the Omaha District, are suffering.

The loss of income on nonaccruing loans is currently about $7 billion. If it remains at $7 billion in 1987 that means at the 11 percent rate, if that is an average on performing loans, they will have potential income loss of $770 million in 1987.

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[1] See p. 248 for the prepared statement of Mr. Kleckner.

On loan liquidations they have had in 1986 net loan chargeoffs of $1.35 billion. It is going to continue very high for 1987 and 1988 and money is set aside that has to be made up. That is also one of their real problems.

I wanted to dwell a little bit more on the high cost of doing business because the ending comment I want to make here, I think, is critical. A lot has been said about the need to restructure the System to reduce overhead costs. That is needed. They have $896 million of other expenses which is salaries, occupancy, equipment expenses, and so forth. But even if they reduce those other costs by 20 percent, and then save $179 million that is substantial. But when you compare that to their loss last year of $1.9 billion, it is not going to make a dramatic difference. Now, I say on the top of page three of my testimony that we recognize that economies of scales do exist.

But we are concerned by those who look primarily at cutting back overhead costs as a way to help the System. In fact, they are simply using that figure to help promote their plan to move the System toward a national bank holding company, more centralization.

We list the seven things there that we would like to see, the principles that we would like to see the System adhere to, and they are very, very brief, and I will not read them. I would like to summarize at the bottom of page three our position on the Farm Credit System. I believe that the System has to deal with all five of the problems that I mentioned previously. Unfortunately, the System cannot simply lower interest rates to borrowers to a competitive level. They must first deal with their problems.

As Farm Bureau looks for solutions, we will keep the following goals in mind. Number one, to make certain that any Federal assistance provided to the System is passed on to the borrower/member. Too often in the past, actions have been taken to save the System rather than the borrowers who are the reason for the System.

The second goal is to protect the value of the borrower's stock, and I believe that was also the intent of Congress in the 1985 amendments. The third goal is to obtain lower interest rates so that the System is competitive with other lenders, and the fourth goal, keep the borrowers fully aware and informed of actions taken by the System.

I would make the following point about agriculture's income and debt situation. The situation is that the problems within the Farm Credit System seem to have intensified even as the income situation in agriculture as a whole has stabilized and improved slightly, and I quote the figure there of the net cash income as you compare cash income versus all cash outlays of $44 billion which is high.

We will probably reach another record in 1987. Agricultural debt is falling I say in the third to the last paragraph. It has fallen over all from $198 billion to $186 billion in 2 years. That is a fall of 6.5 percent. But during that same period of time, the gross loan volume and the Farm Credit System is down 27 percent.

The System is losing loan volume at a substantially greater rate than the overall decline of debt within agriculture and sustaining huge losses at a time when there is a ray of light farm income picture. The increased losses are due to factors within the System and cannot be addressed by policies that shotgun across all of agriculture.

We strongly believe the issues of farm programs and farm credit and then help for the System specifically must be dealt with separately. Mr. Chairman, Senator Boschwitz, we appreciate this opportunity to discuss our views with the committee and thank you for the opportunity to present this here today.

Senator BOSCHWITZ. I will just take over, and I understand, Mr. Kleckner, that you have to leave so that we will conclude your testimony first before we go on to the others. I thought that the farm debt was around $215 billion a couple of years ago. Maybe it was more than that. But I notice you point out that it went from $199 down to $186 billion. That is a decline of $13 billion, while the System, the Farm Credit System, went from $80 to $58 billion which is a decline of $22 billion. Are you saying that other lenders increased their activities?

Mr. KLECKNER. The Farm Credit System has lost more than the overall decline in debt, and as you put that across into the other areas. See, I am excluding here, Senator, farm household debt. The $215 or $216 billion that I heard also was the high may have included farm household debt. I am not sure. Or it may have even been before December 31, 1984. That is the figure that I am using. So the 2 years——

Senator BOSCHWITZ. It looks like other lenders have picked up some farm credit in that case as the Farm Credit System. People switched their borrowing.

Mr. KLECKNER. That is fact. Some of the good borrowers are fleeing the Farm Credit System and picking it up elsewhere at lower interest rates.

Senator BOSCHWITZ. What is the impact? I notice that Mr. Naylor is now talking about the necessity of using the stock, the farmers' stock, as capital to sustain the System. And I suppose that the farmers' stock has to be at risk to some degree. What will the impact of that be if the farmers' stock now gets to be in jeopardy, in your judgment.

Mr. KLECKNER. It would be a dramatic and a negative impact. I suppose that those of us that borrow from the System should have known all along that that stock was in jeopardy. But we have never thought it was. It was just what we invested and paid interest on. That made the effective interest rate even higher than the stated interest rate, and I guess we knew that.

It would have a dramatic impact on farm financial statements if that stock does go down some, or gets used all together. As I pointed out, I think the intent of Congress when they passed the last farm credit bill was to say that stock should not be used or should not be in jeopardy. But apparently it now is.

Senator BOSCHWITZ. Well, it was certainly not clear to me that it should be or that it should not be. I have to go back and look at some of the debate and some of the thinking that we had at that time and see whether or not we talked about that particular point.

Well, I have no further questions. The high cost of money is something that bedevils the System, and I notice that $29 billion, too, is indeed 10 percent or more. I am not quite sure what to do about that inasmuch as you say it is noncallable. It may be that we have to get involved in some buy-down, much along the lines that Mr. Rasmussen suggested on the basis of a loan in order to make them competitive.

I would hope that the System does squeeze down its overhead as one particular element of the whole thing. But I understand that that should not be part of a rationalization that leads to a federalization of this System. Mr. Chairman.

Senator BOREN. Thank you very much, Senator Boschwitz. I apologize. I was called to the phone. I gather from your statement that the decision made in 1971, as we look back on it, of no longer tying the interest rates to the current bond rate, the latest issue, in your opinion now in retrospect, was a mistake for the System?

Mr. KLECKNER. Absolutely was a mistake. The average pricing looked good and was good and encouraged the System to expand rapidly, encouraged farmers to get in because it was well below the competitive, or some below the competitive costs. So the Farm Credit System at that time took borrowers from other parts of the lending System. But the piper has to be paid and is being paid today. Monday morning quarterbacks never lose a game. It is easy to see now that it was a mistake. I would think the Farm Credit System themselves might admit it was a mistake. Those high credit bonds though they are noncallable, but they can be called if you are willing to pay a premium, and the earlier estimate which I think your committee or some committee in the past was using was $3 billion to call those bonds that were above 10 percent.

And again, perhaps in retrospect, it would have been a good thing to do a year ago. It was not done so I sympathize with your problem. What do you do from here because we are where we are today and go from here.

Senator BOREN. Yes. I gather you think that ultimately we are not going to be able to do enough from just savings within the System. We are going to have to have some additional action if we are going to keep it from getting completely out of whack in terms of interest rates and continuing this vicious cycle that we are in.

Mr. KLECKNER. Absolutely. I hope what I said on the savings within the System that if you can save, I pointed out, 20 percent of the cost would be $179 million, and that is a lot of money. But when you look at the losses, that is not going to save the System, and what we are afraid of is that some of those that are saying, let's do all of that, aren't really looking at it. They are trying to make the case and rationalize for more centralization or a national bank type of System which we would be opposed to.

Senator BOREN. Yes, I understand. Thank you very much, and we will allow you to go on so that Delta or whatever will be waiting for you.

Mr. KLECKNER. Mr. Chairman, I am going through Senator Boschwitz' State on the way to Bismarck, North Dakota. You can get to Minneapolis about anytime, but you just cannot get to Bismarck, North Dakota about anytime. Thank you very much. [Laughter.]

Senator BOREN. In our part of the country, if you are on your way to heaven you will have to stop through St. Louis, Atlanta, or someplace.

Mr. KLECKNER. The other alternative, too, of heaven, you have to go through Atlanta.

Senator BOREN. Thank you very much.

Now we are going to move on to Mr. Kelsey. I am privileged the opportunity over the years, to be advised by him, and it has been very valuable advice that I have received. We are very happy to have you with us this morning.

STATEMENT OF JACK KELSEY, PRESIDENT, OKLAHOMA FARMERS UNION, REPRESENTING NATIONAL FARMERS UNION

Mr. KELSEY. Thank you very much, Senator. Mr. Chairman and members of the subcommittee, I am Jack Kelsey, president of the Oklahoma Farmers Union, and I am testifying today on behalf of the National Farmers Union, a general farm organization representing the interests of more than a quarter of a million farm and ranch families throughout the United States. Of those families, 90,000 live in Oklahoma. And on behalf of the members of the Farmers Union, I appreciate the opportunity to appear before your subcommittee and share with you our thoughts and concerns about the Farm Credit System.

I particularly want to thank Chairman Boren for inviting us to participate in this important hearing, and more detailed written testimony has been submitted to you for the record. For now, I would like to outline some of the highlights.[1]

The bottom line is that unless the family farm and ranch is saved saving the Farm Credit System will make no difference. It would be a mistake to implement some sort of rescue plan for the Farm Credit System or the Nation's other agricultural interests without at the same time acting to assure stronger farm prices and income to restore repayment capability. The situation in Oklahoma is much like that in other Farm Credit System districts. Despite enactment by the Oklahoma legislature of a 1-year moratorium on Farm Credit System foreclosures, the System continues to aggressively pursue these proceedings. In addition, Enid Land Bank officials have been quoted as saying they are preparing for a "massive number of foreclosure actions."

We continue to hear reports that the Farm Credit Service of Wichita has instructed member institutions to foreclose a minimum of two farms or ranches per county per month. And that the backlog of foreclosures and other cases has so clogged Oklahoma's District Courts that a 9 to 18 month foreclosure period of Farm Credit Service is now the norm.

These reports come to farmers through their Ag-Link Hotline. The Ag-Link is a statewide counseling service. Another frequent complaint heard on the hotline is that farmers who have been current in their loan payments but whose collateral has been devalued are now facing loan acceleration.

Senator Boren, I have been told by representatives from the Wichita District that that statement is not true and correct. If they can prove to me that it is not true, then I will apologize, but they need to prove it to me. I know of one personal thing, a very close friend of mine faced being foreclosed on due to an expensive and lingering illness in his family. He fell behind in his payment to the Federal land bank. He received a foreclosure notice. In the meantime his finances took a turn for the better and so he offered to become current in his payment and then pay off the remainder of the loan at the regular schedule.

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[1] See p. 251 for the prepared statement of Mr. Kelsey.

The Federal land bank rejected his offer. My friend owed more than $200,000 in his remaining debt. The Federal land bank sold his farm at a sheriff's auction for around $70,000. This one illustration shows how this policy of accelerating loans and not allowing forbearance not only devastates family farmers but the Farm Credit System as well.

Just on this one farm, the Federal land banks lost an opportunity to recoup $139,000, and my friend lost his dream. I know this to be a true statement because this gentleman works for me today. Not all the news related to the Farm Credit System in Oklahoma is bad.

The Farm Credit Banks in Wichita are vigorous supporters of Oklahoma Agriculture Mediation Program. This is a low cost program of voluntary debtor/creditor mediation that we believe will offer many agriculture producers the opportunity to remain in business. They estimate that the cost of this will cost about $150,000, and the Wichita Farm Credit has offered to donate $5,000.

District-wide and nationwide the Farm Credit Service has begun a questionable practice that violates the cooperative principles upon which it was founded. Farmers tell me they feel they no longer have a voice in their own Farm Credit System. The Farm Credit Bank of Wichita pioneered an abhorrent means of disposing of property it has acquired. The banks advertised property for sale and offered financing at a discounted rate of interest and without requiring the accompanying cooperative stock purchase, but only to borrowers with excellent credit ratings within the System or to outsiders.

To emphasize, the Farm Credit System decided it could violate the first principle of a cooperative, that of a farmer-borrower ownership and control. In some cases, farmers who had given up the land could have survived and perhaps even turned a profit if they had been offered the same terms. But when they inquired, they were turned away. We in Farmers Union believe it is morally wrong, if not illegal. It definitely violates the principles of a cooperative.

The Farmers Union must agree with Farm Credit Corporation of America president H. Brent Beesley when he says, "Only with a strong credit system can farmers be sure of a consistent supply of funds, rain or shine. Farmer ownership and control of the System is our best guarantee of that dependability."

Directives from the district level or perhaps higher have sought to undermine that farmer ownership and control by instructing local Federal land banks and production credit associations to authorize consolidation with their sister institutions in nearby towns. Some of our local PCA's and FLBS's in Oklahoma have stubbornly refused to capitulate, and we applaud them. Farmer ownership and control of the System must be restored to the local community level.

Several so-called solutions to the problem facing the Farm Credit System have suffered. To us, the most contradictory is that of Federal takeover in Oklahoma. Twenty-six banks were closed last year, and six banks have shut their doors already this year. These banks were taken over by larger banks.

But the takeover did not include more than $300 million in farm loans, and these farm loans were turned over to the FDIC for foreclosure. This amounts to about 98 percent of the farm agriculture loans. The chance of a farm producer obtaining a new source of credit after FDIC foreclosure is slim at best.

We have seen what a Federal takeover of farm loans means. Clearly, a Federal takeover of the Farm Credit System is no answer. So, Senator, there is a farm bill that will restore farm income and purchasing power while cutting the Government farm costs in half. Improved repayment capability is vital to any of the proposed solutions. It will allow farmers to repay their loans to the Farm Credit System and other lenders.

Restoring farm income is the only prudent solution to the Farm Credit System problems. The need is urgent. The time is now. The failed 1985 farm bill must be replaced by a workable plan of supply management. I believe that is the best answer to the farm income problem, and therefore the farm credit problem. Thank you.

Senator BOREN. Thank you very much.

Mr. Senter.

STATEMENT OF DAVID SENTER, NATIONAL DIRECTOR, AMERICAN AGRICULTURE MOVEMENT

Mr. SENTER. I appreciate the opportunity to appear before this committee on behalf of the American Agriculture Movement today to talk about this important subject of the Farm Credit System and agriculture credit in general.[1]

The Farm Credit System has served agriculture well during its long years of service, but during recent years, both agriculture producers and the System are falling on increasing difficult times. With the Farm Credit System one of the three major lenders in agriculture, it is imperative that we solve the problems and keep this available source of credit for producers.

The System is suffering severe financial problems resulting from low commodity prices. There can be no long-term solution for the Farm Credit System or any agriculture lender until legislation is enacted to raise commodity prices at least above the cost of production.

With the System serious reduction and drawdown in their surplus reserves, this is interfering with the ability to lower interest rates and be competitive in what is offered to farmer borrowers.

We feel like that there have been some bad decisions made throughout the System. As you drive across the country, you can see the building project, the huge investment in capital that the Farm Credit System made during recent years. Almost every county has a new building in it. Now many of those are already standing vacant. The Farm Credit System is also creating severe problems for many borrowers. We are not seeing forbearance practiced for many Farm Credit System borrowers.

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[1] See p. 257 for the prepared statement of Mr. Senter.

Instead, they are pushing many borrowers into bankruptcy and foreclosure that could oftentimes be avoided. Many times when borrowers are foreclosed upon, the Federal land banks or production credit associations offer new buyers, lower interest, better terms, and do not even require stock purchases. It is not right for those associations to offer different terms to new buyers without giving the same opportunity to the existing owners.

We are concerned that this is leading to a lot of uncertainty about the System and the direction it is going. The increases in acceleration of current loans are occurring throughout the System. And what we find out is that when a farmer has adequate collateral to cover his loan, the System is desperate to infuse capital back in the System to keep it operating. So they are accelerating and pushing many farmers out of business that have better loans than many of the farmers that are still financed.

Borrowers are increasingly concerned about the stock. And above all, we believe that borrowers' rights should be first and the System second. We are not finding cooperation between Farm Credit System throughout the country and the Farmers Home Administration and other lenders. It appears that better cooperation would enable many borrowers to use available guaranteed loans and subordinated and different sources to continue to refinance and stay on the land.

We are finding many borrowers that have had to turn to bankruptcy as a last resort in an attempt to save their operations, particularly now under the new Chapter 12. We are finding almost all of those borrowers that have workable Chapter 12 plans in place, they are unable to find any lenders offering production money for the 1987 crop.

It is becoming clear that legislation to correct this problem will have to be pursued along with changes to improve both the Farmers Home Administration and the Farm Credit System.

The American Agriculture Movement has always supported local control of the Federal land banks and production credit associations. We are going to continue our opposition to efforts to centralize control because unfortunately there are many that would use these troubled times as a way to gain control of farm lending.

We believe that it would be far better for an infusion of capital from the Government into the System than leaving the System floundering, trying to recover losses through higher interest rates which puts borrowers at an increasing disadvantage. Thank you, Mr. Chairman.

Senator **Boren**. Thank you very much.

Mr. Buntrock representing NFO.

STATEMENT OF GRANT B. BUNTROCK, ASSISTANT DIRECTOR, NATIONAL FARMERS ORGANIZATION

Mr. **Buntrock**. Thank you, Mr. Chairman and members of the subcommittee. My name is Grant Buntrock, and I represent the

National Farmers Organization, and I certainly thank you for the opportunity to be here this morning. Mr. DeVon Woodland, our national president, has asked me to bring his personal greetings to this committee and also to emphasize our appreciation for your holding this hearing to address the Farm Credit System problems.

I will keep my remarks very brief this morning because a lot of things that I was going to say have already been said here this morning.[1] But I would like to reemphasize the very serious trouble that we as a farm organization, see the Farm Credit System is in. With total loan volume down to farmers and ranchers, the ratio of high risk loans up, another year of reported losses within the System, and yet another increase in the acquired property through foreclosures, that is not hard to see.

In looking at the yearend financial report of the Federal Credit System, it undoubtedly would look even worse if over half of the Federal land banks and one of the PCA's had not utilized the regulatory accounting practices provided in the 1986 legislation to protect the borrower stock from impairment.

Given this dismal financial status, at this point, to my knowledge, neither the System nor the Farm Credit Administration still knows whether it needs financial assistance for the System. The internal conflicts within the Farm Credit System, I think, reflected by some 54 law suits, is another problem. It is a symptom of how much trouble the System is in. And even these law suits may be resolved through financial assistance to the System.

If the System or its regulator does not take action to initiate financial assistance, it may be necessary for the Congress to do this. Overall, the Farm Credit System with the debt and the problems that they have—is not the only lender, of course, for agricultural money with problems. Farmers Home Administration as of the end of 1986 showed total outstanding loans of $28.2 billion. $18.1 billion of these were shown in the delinquent category.

I am sure that some of this figure of $18.1 billion in this delinquent category is probably not all in a real serious situation, but in any case, it is symptomatic of the problems that farmers are having.

Of the total $180 billion agricultural debt $100 billion is carried by commercial banks and other lending institutions which I understand approximately 20 percent of that is also in the high risk category. So far this year there has already been 30 bank failures according to the last figures that we were able to get. Nine of these were in the agricultural bank category.

Even more alarming is the fact the projections for 1987 is that as many as 180 of these banks could fail in 1987. In terms of foreclosures and lack of forbearance and so on, the Farmers Home Administration currently has about 1.4 million acres of farmland in its inventory. I do not have the total figures that the System carries of farmland as a result of these foreclosures. Basically, we feel that the only real long-term solution, of course, is better farm prices. But I realize that this sounds a little simplistic or maybe even unrealistic at this point.

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[1] See p. 260 for the prepared statement of Mr. Buntrock.

But the truth is we wouldn't be here today, as we all know, if farmers had received a reasonable price in the marketplace. In the meantime, until we do get legislation and more favorable prices in the marketplace, we feel it's extremely important that we do maintain the Farm Credit System as well as other financial institutions that are involved in agriculture credit.

One thing that we would ask the Congress is that we do not get in the position to bailout investors, financial institutions or the System itself for that matter unless we are going to strengthen cash flows and provide provisions for owners and operators to stay in business.

We feel basically that refinancing, acceptance of lower interest rates under long-range terms, restructuring of loans, interest buydowns, are several of the things that any lending institution should give first consideration to. The leasing or sale of land that has come into the possession of these lending agencies should be placed with individual owners or operators. We would like to think that the control of our agricultural land, small businesses and so on be in the hands of people with long-standing interests in rural America.

While we are here today to discuss the Farm Credit System as opposed to Farmers Home, I would like to make mention of an emphasis or possibly a policy of the administration in terms of the FmHA guaranteed loans. They seem to be putting most all of their efforts in this direction. We believe that this should be coupled with some strengthening of the direct loan availability.

People still tell us in many areas that there is no money available under direct loan provisions, and are referred to banks for the guaranteed loan provision. In many cases, these local banks involving short-term operating type loans, because of red tape and so on just simply do not want to use the guaranteed loan. Without direct provisions, it means that credit is not available.

One thing that we have heard is discussions in terms of a secondary money market as a possible external source of funding for the System. While we have not seen any specifics in terms of how this might work, we think that it ought to be studied if it would provide the possibility of fixed rates of interest under longer range, lower interest and so on. It is something that we would not endorse at this point, but we certainly think it should be looked into.

We have also heard some discussions in terms of the separation of the joint liability between the districts no doubt brought about by the recent law suits and so on within the System. We simply would be opposed to any separation of liability in terms of these districts. We firmly believe that the survival of the Farm Credit System is going to only survive if it is dealt with as an entire System. And that to allow for a Federal land bank or a production credit association to fail or stand on its own would simply result in fewer Federal land banks, less PCA's in a lot of the areas of the country where farmers would simply not have access to a Farm Credit System.

In summary, we basically feel the farm credit crisis should really be addressed from two fronts. One of them is immediate legislation to improve farm income. That is the only real long-range answer. And secondly, whatever steps are necessary, whether it be infusion of funds into the System, to maintain a viable agriculture credit source, lower interest and so on, simply to hang on to what we do have left of our family farms.

Mr. Chairman, again, I would like to thank you and the members of your subcommittee for this opportunity and your timing and interest in this hearing is greatly appreciated. Thank you.

Senator BOREN. Thank you very, very much.

There are just a couple of questions that I would like to ask each one of you, and then also ask if Senator Zorinsky, who has joined us, has any questions that he would like to ask. First, Mr. Buntrock, you were just commenting on the fact that you would oppose any change in the elimination of the separate liability between districts within the System. Would you take that same point of view even if Congress were to come in with a capital infusion that would ease the current problem? Is that just a matter of philosophy that you think should be maintained in order to assure that, as you said, all areas would be served?

Mr. BUNTROCK. I think for the long-range even with an infusion of capital, we would still look on it as keeping the System intact, and keeping it together.

Senator BOREN. Mr. Kelsey, let me go back and ask you a couple of questions. In your testimony, you touched upon the fact that we were offering better long-term loan terms to nonmembers in some cases than we are to members, and I gather that you feel that violates the basic underlying cooperative spirit of the System?

Mr. KELSEY. Yes, Senator, it certainly does. In fact, I have seen advertisements in the papers where they were offering these sales, you know, at a lower rate of interest and they would not have to purchase stock.

Senator BOREN. Do you also feel that it would violate the spirit of the System to offer large differentials in interest rates even between members? I certainly understand the point you are making about where you have a new borrower who comes in, is a nonmember, who gets a preferential interest rate. Do you think it also violates the spirit of the System that we could even among members have a sharp differential in the rates of interest that are being charged based upon the economic health or condition of the particular borrower?

Mr. KELSEY. Yes, I certainly do. For instance, I think right now they will mark down your interest rates a half of 1 percent if you will fill out a very lengthy financial statement. I find that many of my friends are very reluctant to fill this statement out even to get even a half a percent reduction in interest rates because they are not quite sure what they might eventually do with this financial statement.

They are quite alarmed about that they might accelerate their loan and maybe call it in. So this is a great concern that we have there, too.

Senator BOREN. What about the local control that we have had in the past. We have always had boards of directors of local associations play a role, and of course, partly under the theory that they knew the people they were dealing with. They knew their reliability. As we work on this particular revision of the System and overhaul the System, do you think that it is important that we retain the concept of farmer-borrower control of the System?

Mr. KELSEY. Very definitely, Senator. I think that it is extremely important that we keep this local board. Very few of the boards that voted to do this did it willingly. It was more or less a threat, you know, if they did not vote to consolidate. And they told them, like I mentioned in my statement, to keep voting till they got it right. And I know they did it very reluctantly.

Senator BOREN. Mr. Senter, Mr. Buntrock, would you agree with Jack Kelsey on that point?

Mr. SENTER. Yes, we agree.

Senator BOREN. Jack, again, in your statements, you touch on the problems of RAP, the regulatory accounting principles, you express some concern about that, I believe, in your prepared statement. If borrowers were permitted to write off the reduction in land values they have incurred over a number of years, do you believe that would put most farmers in the black, if they were allowed this same kind of creative accounting?

Mr. KELSEY. Yes, very definitely. In fact, I was visiting with a friend of mine back in my hometown just a few days ago, and I said what would it mean to you if you had your interest written down about 4 or 5 percent? He said it would mean the same thing as another wheat crop to him. So you can see what that would mean.

Senator BOREN. Well, it seems to me if we are going to make creative accounting available, if we are going to be able to solve all the problems by just changing our accounting methods, we ought to make that help available to farmers as much as we are going to make it available to the lenders.

Mr. Senter, again in your prepared testimony for us, you expressed some concern on another matter, the chapter 12 bankruptcy plan, the workability of that plan. You are concerned about producers being able to get credit in the aftermath of this plan. When you are talking about those producers, do you mean those that are also borrowing from the Farm Credit System?

I wonder if the bankruptcy plan provides for any method of repayment to the Farm Credit System institutions that are affected potentially?

Mr. SENTER. I was referring that they are borrowers of the Farm Credit System, Farmers Home banks. They are all in the same position.

Senator BOREN. All kinds of lenders.

Mr. SENTER. The main problem with that plan is the initial money, production money for that first crop because under that plan production money is paid first out of the proceeds. So from that point on then, the producers would be in a position to sell enough wheat or cotton or whatever to cover those day-to-day cash flow needs under those accepted plans. So that initial start-up money is where we are really having problems trying to find anyone interested in financing.

Senator BOREN. Do you think that we should attempt to address this problem within the Farm Credit System itself, or do you think we are going to have to go back into the bankruptcy statutes to try to address it?

Mr. **Senter**. We believe that this problem can be solved through the Farm Credit System and Farmers Home Administration by putting in place regulations or provisions that when there is an accepted plan and adequate cash-flow to keep that operation together that criteria be put in place where the production money can be loaned to those particular entities. So I do not believe it will require any changes in bankruptcy but through the lending institutions that could be required.

Senator **Boren**. Thank you very much. Senator Zorinsky, any questions that you have of this panel?

Senator **Zorinsky**. I would like to welcome the members of the panel and thank them for appearing. Mr. Chairman, I would ask for unanimous consent that my prepared statement be entered into the record.[1]

Senator **Boren**. Without objection. It is so entered.

Senator **Zorinsky**. Thank you.

Mr. Senter, I would like to ask you about how you feel we may keep all the System's good borrowers from leaving? Currently they are doing just that which exacerbates the need for higher interest rates in order to have the System survive. And what are your views on exhausting all the internal resources of the Farm Credit System prior to the infusion of money? Should we do that, or wait until it happens; or do you think we ought to come forth with an infusion of tax dollars before all that internal reserve is exhausted?

Mr. **Senter**. Senator, we are concerned about the low levels that the capital resources are being drawn down to in the System. The lower the resources, well, then those hard-pressed districts are the first to start feeling the pinch. And that is already very evident through the problems in different parts of the System.

It appears to us that it would be far better for an infusion of capital even in the form of a loan that could be repaid in future years over some kind of very lenient terms. The infusion of capital then would allow to solve those individual problems in those different districts, and at the same time part of that could be earmarked to bring those interest rates down to a competitive level which would keep the good borrowers in the System and at the same time it would help cash flow some of the borrowers that are in financial difficulty. Because if you start offering substantial lower interest rates to good borrowers, then the people that need it the most are going to be the ones paying the highest interest rates because they are on the marginal list or with the troubled loans.

So it seems like an infusion of capital, whether it be a loan, or just a direct infusion, with part of it earmarked to bring those interest rates down across the board, would be a way to keep those borrowers in the System and at the same time aid some of the hard-pressed borrowers.

Senator **Zorinsky**. Mr. Buntrock, do you have any comment to make on that?

Mr. **Buntrock**. Nothing more really than to probably back up somewhat what David is saying. I think first of all that the major reason that some of the better borrowers are leaving the System is primarily because of interest rates as opposed to the concern over the stock impairment, borrower stock impairment even though that is a serious consideration. I think the primary reason is interest rates. And it seems to me that if the System is allowed to run on as it is using borrowers' stock as capital, accounting practices and so on, you eventually get to the point where you have nothing left but some of the more high risk borrowers. And the System is in such bad shape at that time that even an infusion after all else has failed at that point in time, you have a long time before you get these borrowers back. So the sooner, the better.

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[1] See p. 241 for the prepared statement of Senator Zorinsky.

Senator **Zorinsky**. Mr. Kelsey, do you have any comment on that?

Mr. **Kelsey**. Yes, I certainly agree with Mr. Senter and Mr. Buntrock, and that is the reason that we are losing our good ones because they are simply finding cheaper money. There is no doubt about that at all. It is quite simple. If they do not do something to help the farmer, this refinancing the Farm Credit System is not going to do any good at all. They have got to do something to either drive down the interest rates or restructure some of the loans or something.

Senator **Zorinsky**. Have you got any suggestions? I have always thought that the farmers could do something for themselves, that is, stop overproducing. Do you have any suggestions on that topic?

Mr. **Kelsey**. Yes, I think we have a farm bill that is coming up that would help the solution with this supply management program.

Senator **Zorinsky**. You mean force the farmer to do it?

Mr. **Kelsey**. Well, it is not really forcing the farmers, you know. They would have to have a referendum vote to do it, and I think it is quite clear that the nonbinding wheat poll showed very clearly that the farmers would like to be in the supply management program.

Senator **Zorinsky**. As a businessman, I tried not to order more inventory than I could sell. Farmers just keep turning it out. I guess that's the nature of a farmer.

Mr. **Senter**. Senator, one of the things that is developing and it is affecting farmers, many of our lenders are forcing us to overproduce because the cheaper the price per unit gets we are put in a position of having to produce more units to cash flow so we can pay the interest and make a principal payment on our debt.

And so we find that quite often when farmers would like to cut back, would like to use a little less fertilizer, but all of a sudden the lenders are pushing hard for maximum production because they see that as a means of us servicing our debt, so it is not necessarily just the farmers. But we are in a position where as commodity prices continue to fall, then we are having to maximize production just to try to stay on the land.

Senator **Zorinsky**. And then that exacerbates the oversupply condition: you have to even produce more the following go-round to keep up with the declining per unit commodity price.

Mr. **Senter**. Yes, sir.

Senator **Zorinsky**. So it is of a catch-22 situation that must be reversed.

Mr. **Senter**. Yes, it does.

Senator ZORINKSY. Thank you, Mr. Chairman.

Senator BOREN. Senator Cochran, any questions.

Senator COCHRAN. I have no questions of the witnesses.

Senator BOREN. Again, I want to thank this panel. Your input has been very helpful, and as I indicated in the beginning, this is an issue that we do intend to address in a timely fashion. We intend to get it on the agenda for full Senate consideration very soon. The Majority Leader not only supports that but insists upon it, and so as we move ahead we would welcome very much the input of all the organizations which the members of the panel represent. Thank you again for being a part of these proceedings this morning.

Mr. SENTER. We appreciate that, Senator.

Senator BOREN. Our next panel is composed of Leroy Watson, the legislative representative of the National Grange; Ron Voth, president of the Oklahoma Wheat Growers Association; and Ray Hankes, chairman of the Farm Credit Task Force of the National Pork Producers Council. Gentlemen, we are privileged to have all three of you with us today. We are on a tight time schedule unfortunately. We are going to try to finish this panel and also Mr. Severens' testimony before we break for lunch. Then we will be coming back, I might say, for the information of all of you who are interested. We will be coming back at 2 o'clock, and at that time begin with the testimony of Mr. Holman, and then we will have a panel composed of the three members of the Farm Credit Administration Board, Mr. Naylor, Mr. Billington, and Mr. Duncan. And we will hear then from the Farm Credit Corporation with the panel following that.

So we will try to move right along, and I will have to depart fairly soon, but Senator Zorinsky will continue, and I appreciate his assistance in this matter to make sure that we complete the testimony by Mr. Severens before we break to come back this afternoon.

We will begin with Mr. Watson representing the National Grange.

STATEMENT OF LEROY WATSON, LEGISLATIVE REPRESENTATIVE, NATIONAL GRANGE

Mr. WATSON. Thank you very much, Senator. I am Leroy Watson, the legislative representative with the National Grange. I will forgo the brief historical and public relations bit that occurs in most of these testimonies and go right into the scope of our presentations today. Our concerns today are more recent in scope in the Farm Credit System. What problems led to the two largest yearly losses of any U.S. financial institution being reported in both the 1985 and 1986 consolidated financial statements of the Farm Credit System.[1]

As we present our views, it is not an attempt to blame anyone or any institution. We believe that no responsibly informed farm borrower, or lender, or public policymaker had any way of knowing that the tremendous farm asset appreciation of the 1970's would have been followed by the disastrous agricultural equity collapse of the 1980's. The most important lesson of the last 15 years of agricultural business cycle is that despite our best efforts to stabilize farm income, the greatest peacetime collapse in our national agricultural economy, specifically the underlying equity values that supported farm loans occurred anyway.

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[1] See p. 262 for the prepared statement of Mr. Watson.

We would be negligent in our responsibilities to both current and future farm families if we did not review the actions that may have contributed to this collapse. We in the Grange believe that the major problem that put the Farm Credit System in its current distress situation was a failure to manage risks starting with provisions of the Farm Credit Act Amendments of 1971 and continuing through today, the FCS, the Government and borrower-stockholder decisions have increased profits and market share along with risk. In my remaining time, I would like to summarize six areas where we believe the FCS's risk management has failed or is failing, as well as a couple of proposals to correct these situations in the future.

Number one is increased loan levels to individual borrowers. During the 1970's, the System's institutions increased their maximum loan levels to borrowers as a percent of both the underlying collateral property value and the total net worth of the loaning institutions. Coupled with employee compensations that were tied to loan volume, these policies helped lead to greater market share for the System, particularly in the farm mortgage market.

This strategy also increased the System's profits. Further more, requiring smaller downpayments for farmers to acquire property extended opportunities for the disadvantaged and would allow efficient operators to start or expand their farming operations.

Against these advantages, however, smaller downpayments decreased the amount of owner equity that is available to cushion land value declines. Large loans as measured as a percent of the local land bank or PCA net worth to a few individual farmers means that the solvency of the entire local associations were often at risk with a few large local farming operations. As larger loans became the norm, the System's management made more and more operating decisions, bricks and mortar, salaries and staffing, based on the profits of the larger loan volumes.

Second, joint liability for systemwide securities issued on Wall Street without adequate systemwide standards of accountability or performance. Briefly, we believe that the System's agreement to be jointly liable for each other's obligations in the financial markets were prepared under the assumption that they would never have to be used. Their primary purpose was to assure investors, Government regulators, borrowers, et cetera, that the System was doing something along this line. They were not viable risk management alternatives.

Furthermore, given recent evidence of law suits and succession fights within the System as a result of the 1985 amendments, we have serious doubts that the assumed fraternal cooperation among essentially distinct and separate local member-sensitive cooperatives is or was possible.

Average cost pricing funded by noncallable securities bearing interest rates that exceed the average cost of funds. That's a mouthful. Many FCS critics point to average cost pricing as a major culprit in today's current System financial crisis. They contend that marginal pricing would have been the wise management alternative. While marginal pricing would have managed interest rate risk, it is not the only way.

Average cost pricing was not in and of itself a disastrous policy had the System's management managed the risks involved. Issuing systemwide securities that contained "call" provisions when those securities had to bear interest rates that exceeded the System's interest averages would have allowed average cost loan policies to continue under basic cooperative operating principles, and it would have shielded the System's institutions and borrowers from the rapid decrease in interest rates.

Four, mergers and consolidations, especially districtwide. System mergers, especially those designed to create large multi-State district associations, are another example of policy that is profit wise and risk foolish. Districtwide mergers may or may not provide the operating economies of scale they advertise. They do guarantee that the failure of a districtwide association will have a broad impact over hundreds of thousands of farm borrowers in several States over the political process and probably the U.S. Treasury, on Wall Street financial markets, and on the rest of the Farm Credit System. Essentially, the bigger they come the harder they fall.

Failure to provide a method, other than foreclosure, for FCS to protect the security interests on property pledged as loan collateral when the deflationary market occurred. In the early 1980's, FCS institutions faced the problem of being the dominant lender in the agricultural credit market segment, farm mortgage and real estate loans, that was deteriorating the most rapidly. Faced with declining equity values to back up farm mortgages, many lenders could either sit back and watch their unsecured exposure grow, or they could exercise preemptive foreclosures to protect what security interest they had remaining from deteriorating. Preemptive foreclosures and sales in a declining market tend to drive land prices down further and faster and foster more foreclosures and more equity and wealth loss for family farmers.

Foreclosures that are based upon protecting collateral security are economically inefficient if they displace a producer who otherwise was an efficient operator with a strong prospect of weathering the crisis. It places unnecessary and intolerable burdens on the lives of farm families who are driven from their farms. It generates tremendous social and political animosity between the farmers and their lenders, precisely at the moment when farmers and lenders need to work together. Failure to devise a method to defer risk in the security interest underlying farm loans is probably the major market failure/Government policy failure in the area of agricultural credit in the past 15 years.

Stockholder/borrower control and stock equity risk. Many farmers/stockholders have lost confidence in their cooperative lenders. In part, they blame the lenders for economic situations that are beyond their control. Rightfully, they also question the FCS's quality of information, opportunity to participate in cooperative policymaking and the ability to speak, or act, as a stockholder without fear of reprisal or retaliation. Increasingly, they are turning to the political process to surrogate for their stockholder management prerogatives.

The 1985 Farm Credit Act Amendments provides an example. Exclusion of stock from the capital sharing provisions of the amendments left borrowers with the impression that Congress removed their stock from risk and the fate of their cooperative has little bearing on the fate of their stock investment.

Combine an FCS that creates an image of confusion, frustration and possibly fear coupled with a political process that is eager to separate equity from risk, and it is difficult to imagine an environment that is less conducive to farm/borrower/stockholder control.

We also have six recommendations to make to the subcommittee at this time that may or may not be acted on either in conjunction with efforts to provide Government assistance or separately. We believe that should any Government assistance become necessary for the Farm Credit System, it should only be the minimum amount necessary, and in no way alter the fundamental relationship between a local borrower and his loan officer. Nor should a loss of local control of the Farm Credit System associations be a price for assistance.

Number one, we should move to create a secondary market in guaranteed farm mortgage-backed securities, and possibly farm operating note-backed securities as well. A secondary market for farm mortgages has been proposed to increase liquidity and competition in the farm mortgage market. In addition, a farm securities market would allow the Farm Credit System institutions to diversify their risk in mortgage and loan operating markets without driving efficient farm families off the land.

Two, review the agreements of joint liability to highlight the risk that individual associations place on the Farm Credit System as a whole and potentially, the U.S. Treasury. Include a review of alternatives, such as an insurance fund system.

Three, review, through the oversight process, the form and structure of FCS stockholder equity and its optimum degree of risk, protection of rights of stockholders as owner/managers and opportunities to enhance farmer/borrower/stockholder participation in their cooperative.

Four, review FCS financing and lending policies based on either marginal cost financing or average cost financing that includes provisions that are sufficient to secure against the prospect of locking in unfavorable interest rates.

Five, discourage for the time being the large System mergers.

Six, review Farm Credit System's lending policies to account for the general risks that increasingly large loans to individuals and increased levels of loan leveraging has on borrowers and the Farm Credit System lenders. That concludes our testimony, Mr. Chairman. Thank you very much.

Senator **Boren**. Thank you very much. I appreciate that thoughtful testimony and welcome the positive suggestions and recommendations that you have made. It will be very helpful to us as we proceed.

At this time I am going to recognize Ron Voth of the Oklahoma Wheat Growers. Again, another individual who has provided to me very helpful advice over the years on agricultural policy, and Ron, we are very glad to have you with us this morning.

STATEMENT OF RONALD E. VOTH, PRESIDENT, OKLAHOMA WHEAT GROWERS' ASSOCIATION

Mr. Voth. Thank you, Senator Boren and Senator Zorinsky, I want to thank you for this opportunity to appear before this important subcommittee this morning.[1] I am also a fulltime farmer and also on the board of directors of the National Association of Wheat Growers, and president of Oklahoma Wheat Growers' Association. I am going to be speaking on behalf of myself as both a Federal land bank borrower and a production credit association borrower. I am in both associations.

First of all, I want to say that my purpose of being here is not to blame anyone or their past decisions on what has happened, or what we see has happened in the Farm Credit System. I think there is enough blame to go around for everybody. But at the same time we cannot avoid looking at our past mistakes and trying to correct them.

Congress and the System have attempted to address our problems in these last 2½ years through various measures, and I think we as producers really appreciate their interest in helping us with this dilemma we are in. I think these attempts were well-intentioned, but in the end we see as producers that we probably just looked at the symptoms and probably have not gotten down to the root problems. It reminds me of where we are at right now, as a farmer if I have a steer out here that has pneumonia, I can drive by and see him standing on the edge of the field, and say, "well, maybe he will look better tomorrow, then I will do something." Then tomorrow comes and I drive by there again, and either one of two things has happened. Either he is dead or if I get him and then treat him for pneumonia, he may live but suffer permanent damage.

This is what I do not think we want to happen to the Farm Credit System. We want to solve the problem and get down the road in a successful manner. As I look at the Farm Credit System, and I emphasize my Farm Credit System, as I am an owner in this System, we have to face the root of our problems.

The important components of the Farm Credit System as I understood them to be were a reliable source of both long- and short-term credit, priced competitively on sound lending principles under the control and ownership of the member borrowers. All this was for farmers and ranchers. My question is have we lost these cooperative principles.

There are many unresolved problems that I see as a borrower in the System that we need to address, and some of them are: nonperforming loans, too high overhead costs in the System, large volume of high cost securities, and the noncompetitive interest rates charged to our borrowers, status of borrower stock, and insolvent associations and banks. Some questions that I have to ask you that I think we need to ask ourselves are these. Is the System too top-heavy and unresponsive to farmers' needs? Are we perhaps so intent on just saving the System that we are not also saving many of our best and most efficient farmers?

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[1] See p. 266 for the prepared statement of Mr. Voth.

And what will happen to commercial size farms should this Farm Credit System fail? Another question is: Are we as borrowers content to let the Farm Credit System become like large central banks that are run from the top down by high-paid CEO's who do not know agriculture?

Nonperforming loans are bleeding this System, and as I see it, we are going to have face these fair and square. Foreclosure and liquidation are not the only answers in many cases. Yet, as I talked about the sick calf awhile ago, when the calf is dead, he is dead. He is part of the death loss. We have to go on. We are going to have to figure out how to take care of this, and we are going to have to go on.

But let us remember to take care of those who will survive if given a chance and an opportunity, and many of these will. Restructuring should make an unprofitable loan profitable, or it is not a viable plan. Also, the cost associated with restructuring should perhaps be picked up by the borrower at a later date. This should be the case even if and when the Federal Government needs to infuse capital in the System. In my opinion, this is a probability and possibly ought to be done very soon.

Senator BOREN. Much as we did in the 1930's. In other words, if there were an appropriation, it would be anticipated that it would ultimately be repaid?

Mr. VOTH. Right. That is my thinking. The direction we are headed right now, in my opinion, is a self-destruct situation. We are continually on this self-destruct path by just continually shoving good loans over closer to the edge and shoving them off the side. This has got to be stopped.

Of course, high overhead is also eating up our profits in the System. Our banks, the association, Capital Corp, and I might say the stockholders, cannot afford many of the luxuries of the past. We as farmers have had to cut back on our expenses and be more efficient and productive. So the System needs to do likewise. I will say we as borrowers are watching closely. I say that in all honesty.

I would be remiss if I did not express some observations concerning the Capital Corporation and the special asset group they established to service nonperforming loans, and to manage acquired properties. I have not heard too much said about this morning. They operate outside the control and the supervision of the district banks and the association boards of directors on the association and service center level.

This has created confusion and misunderstanding among the stockholders in this System. Since the special asset group has attracted many of the former administration administrators and loan officers, it has created a shortage of experienced personnel to properly conduct the business of these associations.

It further illustrates the need for the System to put more emphasis on developing programs to help the solvent stockholders instead of waiting until the delinquency occurs. Would it have been more feasible to have let the associations continue servicing the nonperforming loans under the supervision of the Capital Corporation, thus eliminating the confusion.

Also, we need to look at our pricing of our interest. In my opinion, we probably made a mistake when we moved from pricing our interest in using the average cost. It was great when land prices were inflating, but it put an artificial value in land, and we are paying for it today.

Some of the keys that I think we need to look at if we intend to keep our good borrowers and those who are highly leveraged, are as follows: Interest rates for all borrowers in real terms must be reduced to a competitive rate as required by the original law.

Also, we must reduce interest to all borrowers if they are to stay with the System also and to survive until profitability returns. I might emphasize we need both types of borrowers.

Stock is a hot button for everybody. The question I hear asked is why are borrowers are so scared they are going to lose their stock? I think in simple terms the reason why they feel is that it is an added cost that they would have to pay on an already shaky loan. Stock impairment would probably cause panic as does a run on a bank when confidence is lost in the bank. My advice is to leave stock alone. I might say in that vein that myself personally I am in a production credit association. If somebody told me tomorrow or the next day that my stock was going to be impaired or I would not be getting stock reduction when I paydown on principal, I would leave. I have a line of credit already set up at a bank, and I would move day after tomorrow. That is how close it is.

The keys for survival in our local associations, I think, are these. Return the control of the local associations back to the local boards. The employees of local associations and district banks need more latitude in servicing loans. Association paperwork in application has more than tripled, neither to the benefit of the lender nor the borrower. System employee morale and turnover is less than acceptable and sure needs attention.

Let us remember that the local loan officer and borrower started this relationship, and it takes each one's belief, confidence, and cooperation. This is absent in many cases today. We need to make good sound loans based on competitive interest rates, sound lending principles to all borrowers, not a select few.

Let's talk about capital infusion. I might say on capital infusion that I feel that should capital infusion be necessary, it should not be part of the ag-commodity budget since this is a banking and/or Treasury function. This is something we really firmly believe.

One other thing here. More emphasis needs to be given to the borrower's managerial ability and to rate loans on its collateral position in determining the interest rates charged or rating of loans. Loyalty and confidence, I think we all agree, is important in any business. The only way this is going to be restored is if we do many of these things which I have mentioned here. We are losing borrowers at an alarming rate.

I know we are not going to save everybody. But I know we are losing a lot of people that would have a chance to survive if we would address these principles that we talked about here today. We as farmers need your support in helping this Farm Credit System back on its feet, but I think even more importantly, we need help for commercial family farmers to get back on their feet. There is a direct relationship and correlation between farm income and a farmer's ability to service debt.

We as an organization of wheat producers are vigorously looking to any way we can to improve the Farm Credit System and also are working to put profitability back into the wheat industry. I will assure you that we will not be sitting on the sidelines at this important period. I want to thank you for your kind attention and for this opportunity to give you my ideas. Thank you.

Senator BOREN. Thank you very much, Ron. I think the key is we have to get off this path toward self-destruction on which we obviously are embarked. It is just clear to all of us, and we have to find a way to break out of it, and headed back in the right direction. I appreciate your comments very much. We are going to hear next from Ray Hankes. I apologize as I am going to have to go on to another meeting that unfortunately I have been called to. But Senator Zorinsky has graciously consented to chair the remainder of the morning session. I will be back at 2 o'clock, and I want to assure you that I will read your testimony with great interest. I have already seen the written submission and also Mr. Severens' as well.

Mr. Hankes, we are very glad to have you with us this morning. Please proceed.

STATEMENT OF RAY HANKES, CHAIRMAN, FARM CREDIT TASK FORCE, NATIONAL PORK PRODUCERS COUNCIL

Mr. HANKES. Thank you very much. My name is Ray Hankes, and my family and I farm in central Illinois. We have a 5,500 head start to finish operation and crop about 700 acres, principally corn and soybeans. I am also a member of the National Pork Producers Council Executive Committee. We are pleased to be here today on behalf of our over 100,000 members of pork producers in 44 States. As you know, Chairman Boren, Oklahoma has a large hog population located mostly in the eastern part of your State, and Senator Zorinsky, I don't have to tell you how important hogs are to the agricultural viability of your State.[1]

Farm credit is vitally important to those producers, to me, and to all pork producers in the United States. The NPPC is extremely concerned with this area, and consequently we have formed a task force to consider the full extent of the problem and the solution. We do not have a solution as we have already heard that there are no easy solutions. If we did, we certainly would have offered it long ago and the Farm Credit System might not have gotten into the problems that have caused the large losses that have been recently announced had there been easy solutions.

I serve as the chairman of the NPPC task force, and we have recently spent 3 days here in Washington talking to Members of Congress, the Farm Credit Administration, the Farm Credit Council, the insurance companies, and others about the Farm Credit System and other sources of credit.

It is interesting to me. A story was picked up on a radio station that we had been out here talking about the farm credit area. Our local newspaper editor picked up on this, and wanted to do a story.

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[1] See p. 268 for the prepared statement of Mr. Hankes.

Sometimes we try to avoid our local newspapers but in this case, I relented, and he came out and did a story, and it appeared on the front page of our local paper there in Fairbury. It was fairly accurate, and he did a good job with it. And last week I had the occasion to go to a fertilizer meeting and a chemical meeting, and then Saturday an FFA businessman's breakfast. I had between 25 and 30 farmers walk up to me and personally want to know what is going on in this area, what the status of the System is, expressing their gratitude that we are involved, and their real concern.

This was just really in a small community, and I think this same concern is true all over the country, and this is really an important issue and a hot topic back at the farm level.

After our fact-gathering session, we arrived at eight statements of principle and concern. All these statements reflect the overwhelming desire of the task force members to preserve credit for agricultural borrowers. Our concern is that creditworthy borrowers have the ability to borrow. We have lesser concern about what the System is called, how it is structured, and who administers it. These statements of principle and concern have been formulated with the intention of developing a National Pork Producer Council policy and action plan on farm credit.

I would like to cover these statements now. The first one is the cornerstone of our policy statement on credit, and that is that credit at competitive interest rates must be readily available to all creditworthy agricultural borrowers. And I think that everyone here can agree on that.

The NPPC urges the administration and Congress to recognize the immediate and critical nature of the farm credit problem, and to take steps to rectify these problems with more permanent solutions. Obviously, the Senate is and has recognized the immediate and critical nature with the actions that are being taken by this hearing and promises that we have had that there are going to be some permanent steps taken to help solve the problem.

The NPPC supports the incentives to credit agencies to restructure present farm loans rather than foreclosing on troubled loans that have potential for repayment because of positive cash flow. In other words, just because the asset to liability ratio has dropped down to one, and a person is cash flowing, and he is not behind in his interest and principal payments, let's not close him out. And that is happening now.

The NPPC supports the creation of a secondary market for farm mortgages to be available to all lenders for farm real estate loans. This increased availability of funding should reflect to the producers the greater competition in providing for credit needs, consequently resulting in lower interest rates.

The 1985 and 1986 amendments to the Farm Credit Act have not brought about a resolution to the Farm Credit System problems. Any Federal aid to the Farm Credit System should be linked to a reorganization plan that would ensure long-term solutions to the Farm Credit System's problems with the primary goal of assisting farmers' credit needs.

Such a request for aid should be considered in a properly deliberative manner to ensure the maximum farmer input and consideration of protecting borrowers equity. If a capital infusion is needed to rescue the Farm Credit System's viability, it should not be at the expense of existing agricultural programs.

The FmHA should remain as a viable source of credit to farmers within its present lending parameters. Sufficient funding should be made available, allowing the Farmers Home Administration to pick up the portion of the farm credit needs that qualify for this program.

Our delegates are going to consider these different statements next week at the American Pork Congress, and we will surely get back to you with the results of their approval of these which we are pretty sure is going to happen. We also want you to know that the National Pork Producers Council stands ready to assist this committee in any way. I would be pleased to join forces with you and the committee to help put an end to the recurring nightmare that American farmers have about not being able to secure credit or maintain loans that are already in existence. Thank you very much for allowing us this opportunity to share these thoughts with you.

Senator ZORINSKY [presiding]. Thank you, Mr. Hankes. I really appreciate the comments made by the panel. They will certainly be able to give us guidance and direction as to our future path in resolving some of the more imminent crises we face in sustaining the Farm Credit System. Would any of you care to comment on your views or feelings with respect to the judicial actions taken by the more successful districts. They have dollars available as a result of belonging to the System now, a time when there is extreme financial pressures on certain parts of the System. Do you feel that they should not be required to share their reserves with those that are in trouble? If you feel they should, should any leverage be applied by the infusion of the Federal tax dollars against those reserves being shared by the entire System?

Mr. HANKES. I will start. That is a very complicated question, and again, there is no easy answer to it. But if we believe in the principle of local control, to some extent some of those local associations got that way because of individual problems. But also we heard earlier, and you did not have the opportunity to get the historical perspective that was presented so well earlier this morning, that it was the original intent that, and when the infusion was made which was a loan in the 1930's, that that did bring about a uniform lowering of rates across the country.

The differences in rates today make it more difficult for people in some areas of the country to compete. And as far as the judicial action, and should those banks be forced to share those reserves with others, it might be more appropriate to put the money where it is needed as opposed to lowering reserves in one area and then just spreading that out.

Senator ZORINSKY. So I do not get you wrong, in other words, you are saying target the Federal loan window to the need rather than to the System?

Mr. HANKES. That is true. I think I said in my statement, and this is a pretty clear direction from our producers. We are interested in saving farmers and we are not as interested in saving the System. I really think we probably need to save the System to save the farmers, but let us put the farmers at primary importance.

Mr. WATSON. Senator, the National Grange is a national farm organization, and as such we have farmer members in districts that are in vital need of capital inflow, and we have members in districts that are subject to assessments in capital outflow. And it is an incredibly difficult question.

Internally, there seems to be little consensus. In looking back at the structure of the System, though, it is hard to fault supposedly a member cooperative responsive to its local members instances that tries to protect those local member interests, and particularly, in the case of trying to hold on to whatever capital reserves a fortunate district or association may have. I think that that is probably if we can look back and take an overall view of the situation and look at it, that is not an unusual, or should not have been a surprising occurrence. That given hard times that many people would circle the wagons rather than hold out and hold hands sometimes. I think the challenge now is to try and derive the best public policy system that either accounts for the fact that when push comes to shove, you are going to find a lot of indication that people are going to tend to rally around and be conservative in what they are willing to share.

Or change the basic structural composition so that it is more apparent up front that the cooperation among system entities is as important as an entity's responsibility to its farmer borrowers.

Senator ZORINSKY. Mr. Voth?

Mr. VOTH. Where I come from, and of course, I represent also the National Wheat Growers here, our feeling is kind of like my mother-in-law driving off the cliff with my new Cadillac. We are receiver at the present time, but I can sure understand the other side of this thing, too, because I am involved in a production credit association that is in very healthy financial condition that is in a lawsuit on being assessed. So I understand the feeling. I agree with the principle of targeting these if we look at targeting funds to alleviate this situation. This would be my thinking that it would be the correct way in my mind. Let me emphasize again that I think that it is reasonable to ask that those associations which I am a part of would pick up and pay back what money would be expended into these targeted areas at a later date. I think we would be willing to do that.

Senator ZORINSKY. Yet you and I and Senator Boren, although I cannot speak for him, would certainly not feel that because Oklahoma and Nebraska are successful in football programs and derive a lot of money through television appearances that it not be shared with the rest of the Big Eight. When an entity is successful, it has to share among its parts, if that is the understanding from the outset.

But I am concerned that right now you have your cake and eat it, too. If you are with a failing team, and you are more successful than the rest of the team, you get off the team if you don't want to share the misery and go your own way. But we are talking about Federal tax dollars, and certainly tax dollars should be expended in the most prudent and fiscally responsible manner. We haven't talked a lot about targeting Federal tax dollars with respect to saving the Farm Credit System. We always refer to it as a system, with its total net worth and value, and total reserves available.

And maybe if your case is "leave me alone because I'm doing well," as some of you have pointed out, we should segregate the saving dollars for those systems which truly need to be saved.

Mr. WATSON. Senator?

Senator ZORINSKY. Yes.

Mr. WATSON. To the extent that Federal funds may become available, it might be an interesting twist on public policy to——

Senator ZORINSKY. You say "may become." Is there any doubt in your mind that, number one, the day is not very far off when the money has to come?

Mr. WATSON. Well, as a policy position, the National Grange has not said there will be money at this time. I think looking at the issue as I have it is probably going to be soon, if not—well, my personal guess, and if I've got a pool, anybody else does. It is the second quarter of this year that we are looking at the situation.

But it might be an interesting situation that as a condition of that, that System institutions be required to, or encouraged to, or however involved there, to drop the series of lawsuits in favor of either an arbitration process or a negotiated rulemaking process with the FCA so that we can finally put aside what many system institutions claim to be either unconstitutional or wrong regulatory practices. We are more than willing to share everything we have, but this is just the wrong way to do it is part of the basis behind many of the suits.

I think it might be possible to cut through that with either, as I said, an arbitration or a negotiated rulemaking process that makes sure that everybody understands and contributes to what the rules and regulations are and then abides by them, and we move it quickly.

Senator ZORINSKY. It bothers me that we are creating regulatory authority for the creation tantamount to two sets of books for the Farm Credit System which the entire System can utilize whether it needs it or not. This then begins to falsify the actual strength and net worth of some of the district entities of the System that do not need that second set of books. So while we are trying to prop up the need in some districts, we are also liberalizing the ability of sound financial districts to take advantage of the same rules and regulations.

Mr. HANKES. Would it not be possible through some process to allow those sound districts to lend money to those that were not so sound also, instead of forcing and going through again the process that seems to be undesirable. Maybe we could step back and take another look at that.

Senator ZORINSKY. That is an alternative, and we ought to look at all the alternatives. Of course the bottom line is, what is the cost of that alternative, and what is the ultimate rate of interest by the borrowing of that money would provide for the farmer in those needy districts.

But certainly it is an alternative, and I think it is an obligation upon us to explore and evaluate it. I want to thank you for your presence here and for participating in these hearings.

The final witness in this morning's session will be Eugene Severens. Eugene Severens is a staff attorney for the Center of Rural Affairs in Walthill, Nebraska. Gene has spent the last 7 years working on farm credit issues. He is a coauthor of the Farmers Home Administration Farm Loan Handbook, and has spent a considerable amount of time developing comprehensive legislation for reforming the Farmers Home Administration, some of which was incorporated into the credit title of the 1985 farm bill.

Gene testified recently at the Omaha Farm Credit hearing on February 10 of this year. I am pleased that you are able to join us today, Gene, and I welcome you to our hearing.

STATEMENT OF EUGENE SEVERENS, CENTER FOR RURAL AFFAIRS, WALTHILL, NE

Mr. SEVERENS. Thank you very much, Senator Zorinsky. My name is Eugene Severens, and I work, as Senator Zorinsky said, for the Center for Rural Affairs in Walthill, Nebraska. Senator, in light of the circumstances here, and the fact that part of my testimony relates to a case study which looks at Farm Credit System lending in Nebraska, with which you are quite familiar, I think I will attempt to summarize my testimony even more drastically than I had originally intended.[1]

I think in many respects, Senator, the Nebraska sandhills represent in many ways the last large American frontier in farming. Capital, whether through investment or debt financing, brought together in the sandhills enormous stretches of cheap ranch land and new technology of center pivot irrigation to grow even more surplus corn. The magic alchemy of easy debt and new irrigation technology could turn $200 per acre fragile grazing land into $1,000 per acre corn ground practically overnight.

This irrigation development in the sandhills was strenuously opposed and criticized by many who saw it as an eventual ecological disaster and a financial boondoggle. The local boards of the PCA's and the Federal land banks in the sandhills area were themselves opposed to many of the irrigation loans, but they were overruled by the Omaha district bank.

These Omaha district officials of the Farm Credit System defied the critical analysis and helped make sure that that boondoggle became a reality. The results were not only the predictable ecological disaster which Federal taxpayers must now pay to correct and the inevitable financial boom and bust, but also the eventual destruction of two Nebraska PCA's and permanent critical financial injury to every single owner-member of those PCA's. I'm speaking, of course, about the Valentine PCA and the O'Neill PCA which were liquidated about 2 years ago.

What are the ingredients of this failure in this particular case study? Without going into all the details, our analysis of the financial troubles and eventual forced liquidation of the two sandhill PCA's points to several basic problems that point toward the need for future reforms.

First, an uncritical and unprofessional faith that land prices could perpetually inflate beyond farm lands earning potential, and thereby serve as collateral for any manner of loan.

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[1] See p. 269 for the prepared statement of Mr. Severens.

Second, a disregard for the healthy conservative lending practices espoused by the local association boards. Third, allowing a disproportionate amount of an association's loan portfolio to go to one or two high-rolling investor farmers. I might add that in the case of the Valentine PCA, of the $12 million in bad loans, $8 million were held by one single investor farmer, and I think that one single fact contributed perhaps more than anything else to the disaster of the liquidation of the Valentine PCA. Finally, effective abandonment of eligibility criteria which limited lending to owner-operators in favor of the meaningless criterion of bona fide farm owner, an open-ended eligibility criteria that allowed loans to farmland investors.

Senator Zorinsky, with the rest of my time I really wanted to turn to a slightly different subject dealing with ways to bail out the Farm Credit System. As you said just moments ago, it is all but inevitable that some injection, infusion of Federal funds is going to be necessary.

We would like to present to the subcommittee, since it will be your basic responsibility to fashion this bailout, one possible approach to this problem. It's not a complete answer by any means, but it is an answer that has some intriguing possibilities. I will be reading now from my prepared statement at the bottom of the second page.

Historically, the most successful Federal agricultural credit program has been the providing of modest loan funds for individuals to build up efficient family-size farm units. This basic concept was behind the original creation of the Federal land banks 70 years ago. It was the basis of the Bankhead-Jones Act in the Depression, and it finds its current manifestation in FmHA's Farm Ownership Loan Program.

Components of this successful approach include limiting loans to efficient family-size operations; limiting the amount of the loan to a modest amount; and protecting the Government's investment by fully securing the loan by the property being purchased.

So what does this have to do with bailing out the Farm Credit System? As is generally acknowledged, the Farm Credit System is in need of an emergency infusion of Federal funds and it happens to own about $1.2 billion worth of farmland in its growing inventory, land that can be sold to infuse cash into the System. If Congress responds to the need for a fund infusion, what better way to design that infusion than by providing FO-type direct loans to eligible family-size borrowers to purchase Farm Credit System acquired properties. For lack of a better term, we are calling these loans envisioned by this concept FO/FCS loans.

The important point here, Senator, that I would like to underline is that I think there is a second stage to this crisis, and one of the important points is going to be which farmers are in a position to buy the vast amounts of lender inventory land that is hanging over the market.

The Farm Credit System holds the majority of the land in the lender inventory market. At the beginning of the session, Senator Boren listed a number of questions that this subcommittee would be addressing, and I would like to throw out on the table the possibility that a new question needs to be added to that list. And that question is how do we make sure that the sale of Farm Credit System acquired property is done in an orderly manner? And secondly, should Congress influence how the sale of that inventory land is targeted, to whom it goes to?

What exists on the rest of the third page of my statement is a number of points about this proposal that we are making in terms of using the Farm Credit System inventory as a way for quickly and efficiently infusing somewhere between $1 and $2 billion into the System, not enough to satisfy the System's loan losses, but certainly a beginning point, and an approach that will serve double-duty, in that not only will it achieve the desired purpose of infusing cash into the System, it will also further the long-standing public policy of opening farming opportunities for reentry farmers and beginning farmers on a reasonable basis.

I have listed here about eight or nine points, arguments that can be made in favor of this kind of approach. I will not go through them right now, Senator. I mentioned them in my Omaha testimony at the field hearings by the Senate Ag Committee. But I would like to leave them with the committee for their consideration. That's the end of my testimony.

Senator **Zorinsky**. Without objection, your entire evidence and statement will be put in the record.

Mr. **Severens**. Fine. Thank you very much.

Senator **Zorinsky**. Gene, I would like to ask you about the farmer-owner program with respect to selling back current inventory in the Farm Credit System owned by the System itself. At what price would this be evaluated? Current market price, or the dollars invested in the land at the time it was taken?

Mr. **Severens**. I think the land should be sold at its current market value, Senator. And sold using the open market as a guideline for the sale of the property. There may be some way that——

Senator **Zorinsky**. Would that be a bidding process or would someone determine who would get to buy it and who would not get to buy it? As you well know, a lot of people are waiting to see if we bottom out on land values. Certainly if all of it were to be dumped on the market at low land values it would trigger additional rounds of lower land values. And that would exacerbate the problem of some farmers who are just hanging on with minimal collateral ability to generate cash flow.

Mr. **Severens**. I think there is room for some innovative approaches here. I might call to the subcommittee's attention the way that theoretically the Farmers Home Administration is supposed to sell their farmland, and in that scheme of things, the Farmers Home Administration, which is the second largest holder of inventory land after the Farm Credit System in the country, the Farmers Home Administration land is supposed to be made available first to FmHA eligible borrowers at FmHA financing terms. As I read the law, that period is supposed to last for approximately 3 years. The property is classed as suitable property. If there is no eligible buyer coming forth at the end of 3 years, it is then sold as surplus property on the open market.

And the way the law passed in 1985 deals with that particular sale is if there is more than one interested and eligible Farmers Home borrower during the period of time when it is held open for

FmHA eligible borrowers, it is the decision of the county committee after comparing all the eligible candidates to decide which one, in fact, will get to buy the land. That is the system designed now in the Farmers Home Administration. It may not be the best approach. It is an attempt to make sure, however, that abuses do not occur, that not too much power is placed in the hands of, in this case, a Farmers Home local official, that there is, in fact, kind of a check and balance in the system to delegate responsibility for this very important decision in a way that meets a lot of different criteria.

Perhaps the same kind of approach could be used in the case of Farm Credit System inventory land. I think there is a lot of thinking that could be done on the whole issue of how to dispose orderly of the Farm Credit System inventory, and in particular, in making it available to family-size farm operations.

I had one other point I wanted to make, but perhaps it will come up later. I have lost track of it.

Senator ZORINSKY. It is my understanding that you believe the public purposes for which the System was originally established and founded could provide a valuable lesson for us today. Can you elaborate on your feeling?

Mr. SEVERENS. Well, I think that the Farm Credit System as it was built up over the years was really designed for a family farm system type of agriculture. And that was when the Federal land banks were first created in the 19-teens. This was the type of agricultural system we had. It was only in the late 1960's and the early 1970's with large inflation of land values and a certain mystique seemed to take over the upper levels of the agency to make it become one of the most powerful lenders, the whole drive to centralize it, the whole drive to use inflating land values as collateral for encouraging people to get bigger and bigger and bigger.

Much of that movement away from the more modest role of the agency, or of the Farm Credit System, and the more modest vision that it was simply there to correct a certain deficiency, not take over agricultural lending. The growth in the share of the Farm Credit System lending in the 1970's, I think is an aberration of the original vision. It was not supposed to become the dominant lender in the field. It was supposed to correct certain deficiencies in the allocation of agricultural credit. The deficiencies that local banks, for example, as Mr. Rasmussen stated this morning, local banks were not able to provide the long-term credit that farmers needed to purchase land back in the 19-teens.

And so the Federal land banks were designed to address that particular problem. The purpose of the agency was, in a sense, remedial and seen as complementary to the other lending institutions. It was never really intended, in my opinion, to become the dominant lender in the field and take over the field in the way that it did, and by the devices that it did, and I think it is paying the price for its own vision that went awry in this case.

Senator ZORINSKY. You mentioned other lending institutions. Do you feel that whatever we do in the way of an influx of Federal tax dollars to the Farm Credit System should be done in consideration with whatever negative impact it may have on the rural independent banking system, the private banking system? There is always an effect on the independent bankers in the rural areas more so than any other place. They are directly affected in the competition of low interest rates, fighting against the infusion of taxpayers' money with respect to them generating their own private dollars.

Mr. **Severens**. Right. I think that part of the flight, as people have been referring to it this morning of borrowers away from the Farm Credit System, is exactly what the entire agricultural lending system predicted should happen and is designed to happen. By that, I mean the Farm Credit System in the 1970's took the risk that by average cost pricing of their lending that they were going to, in fact, steal borrowers from other lenders by their lower interest rates. That worked as long as interest rates went up. Their average rate was going to be lower. They were going to be more competitive.

And the downside of that is they lose when interest rates go back down. So it is only to be expected that this flight takes place, and that now we are seeing the competitive advantages return to local lenders, local banking associations, local banks. I think there is a certain amount of justice in that quite frankly. It was a risk the Farm Credit System took and it lost.

I think that it is important to remind ourselves, as I stated earlier, that the Farm Credit System was designed to remedy deficiencies in the overall agricultural system, just as Farmers Home Administration was. They were never designed to be takeover agricultural lending industry. I think we do have to take note of the positions of other lenders that, in effect, provide the backbone and provide stability to the lending community. I might make one other point, Senator Zorinsky, and that is the particular plan that we are suggesting here, the use of FO loans that are used to buy lender inventory land, will work for other lenders as well. And it is an automatically targeted system in the sense that the more land a lender has in their inventory, the more they will get the benefits of this program.

If the Omaha Federal Land Bank has more land, more acquired property in its inventory, it will get more benefits from this approach than the Federal land banks in Springfield, Massachusetts. And similarly, if the approach were applied to commercial banks, the same result would hold. The program is automatically targeted to those that have more land in their inventory.

And it is, in a sense, not a transfusion of funds to a particular lender. It is, in fact, loans to individual farmers who then buy the land from the lender inventory. The only string attached to these loans is that the money must be used to buy land from a lender inventory.

Senator **Zorinsky**. Thank you Mr. Severens. I appreciate your testimony. As always, you are very concise and very articulate, and thank you for being here.

Mr. **Severens**. Thank you.

Senator **Zorinsky**. The committee hearing will be in recess until 2 p.m., this afternoon. We are in recess.

[Whereupon, at 12:50 p.m., the committee recessed, to reconvene at 2 p.m.]

AFTERNOON SESSION

Senator Boren. I apologize for the delay in getting resumed here this afternoon. Our first witness is Luman Holman, the executive director of the National Association of Farm Credit System Stockholders, and I understand, Mr. Holman, that you are also representing the Federal Land Bank Associations of Texas Stockholders Defense Fund. We are very pleased to have you with us, and again our apologies for being delayed in getting started. We welcome your statement at this time.

STATEMENT OF LUMAN W. HOLMAN, ON BEHALF OF GRASSROOTS: THE NATIONAL ASSOCIATION OF FARM CREDIT SYSTEM STOCKHOLDERS AND THE FEDERAL LAND BANK ASSOCIATIONS OF TEXAS STOCKHOLDERS' DEFENSE FUND

Mr. Holman. Thank you, Mr. Chairman. I appreciate very much the opportunity to testify on behalf of the two institutions that I represent. First of all, let me say that the aim of the shareholder organizations that I represent is to encourage farmer and rancher-borrowers participation in the management, the control and the ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit.

You, of course, I presume, Mr. Chairman, will recognize that I have just been quoting from the policy and objectives section of the Farm Credit Act itself. However, I want my citation of these words to the Congress to show this subcommittee that the shareholder groups that I represent and that I am speaking for today want to preserve the Farm Credit System as Congress founded it.

Today the problem is not with the Congress or of the stockholders of the System whom I believe see eye-to-eye. The problem is with the Farm Credit Administration and the System's top management. Mr. Chairman, as you yourself said on the floor of the Senate on October 17, 1986, and I quote: "Despite the fact that thousands of farmers are being foreclosed this year by the System, the System has expressed no desire for legislation to prevent the massive foreclosures. Further, the System has failed to come forth with any meaningful restructuring program to keep producers in business.

"The System apparently doesn't see its purpose as keeping farmers in business anymore. Like many large organizations, the Farm Credit System appears to have become a bureaucracy interested only in perpetuating itself."

Especially in today's difficulty, shareholder groups need the System to stay alive and carry out the essential farm credit functions in a sound and a responsible manner, while at the same time preserving local control and management that are the hallmarks of a truly cooperative System.

The Congress has worked very hard in the past and has already, as you know, passed two relief acts, the Farm Credit Amendments of 1985 and the Farm Credit Amendments of 1986. The question then arises why have these acts given so little redemption and relief to the stockholder/borrowers and the System institutions?

The first culprit is the Farm Credit Administration. FCA has continually defied the Congress and acted to thwart effective System self-help and to drive all System institutions to the brink of capital impairment or beyond.

I attach a couple of instruments that I think you will be interested in seeing. Two courts have already held that the assessment regulations that have been promulgated by FCA are in violation of the acts of Congress. I refer to these instruments and I submit them to you for a portion of this testimony. Of course, I am briefing my testimony, but these are included.[1]

In October 1986 when Congress passed emergency legislation to permit the use of regulatory accounting procedures in lieu of GAAP, from July 1, 1986, taking into account loan loss situations back to the first of the year, Congress again was acting to conserve the resources of viable lenders.

FCA, however, has taken a highly restrictive approach to regulations under the 1986 amendments, and as a result is unnecessarily increasing pressure on all System institution balance sheets. FCA's continuing hostility to letting viable Farm Credit System lenders continue making credit available to farmers on reasonable terms is in direct conflict with congressional directives that FCA's approach to loss sharing and assistance to its most troubled borrowers should be based in a way that they would avoid impairment to the viable lenders.

This is a very important aspect, and I submit to you that the point is that FCA's refusal to protect the dwindling viability of the System's remaining institution forces litigation, and it creates the appearance that the "have" banks are not willing to share with the "have not" banks. The reality is, however, that hundreds of millions of dollars have already been shared with System institutions.

The simple fact remains that the demands of the Farm Credit Administration's assessments and regulations transgress and circumvent the law as several courts have declared.

The other culprit in the System is the top management in the System, not the owners, not the shareholders, the hired hands who want to replace the present decentralized structure with a single central entity, a super-bank, if you please, Mr. Chairman and gentlemen. Make no mistake about it. The real agenda of the top management of the Farm Credit System is the waging of a relentless, ceaseless and self-serving effort to destroy the Farm Credit System as a decentralized System of banking cooperatives.

Let me draw your attention for a moment to the document attached to my prepared statement. This document is an August 1986 communication from Grant Lucas, the chairman of the Farm Credit Corporation, one of the service organizations chartered by the Farm Credit System. The FCCA document is a resolution stating that the Farm Credit System should adopt in place of its current structure a single national superbank to service the entire country.

And lest anyone should think that they want to achieve this end through voluntary shareholder action, their implementation plan recommends the use of the Capital Corporation as a tool. I repeat "as a tool" to facilitate the accomplishments of the plan. After public exposure, however, we are told that another vote rescinded the adoption of this plan, but the fact remains that so elaborate a scheme was surfaced and publicized in late 1986 tells you where these men still are for they are the proteges of those who originally proposed "Project 1995" to create the super-bank, something, Mr. Chairman, you yourself have addressed on the floor of the Senate heretofore.

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[1] See p. 271 for the prepared statement of Mr. Holman with attachments.

The System's present organization is a good one, basically. The 37 banks using private capital and owned by local farmer-rancher stockholder-borrowers supply one-third of this Nation's overall agricultural credit on the basis of local knowledge and local conditions. The System belongs to the borrower-stockholders, and we do not need it to be refashioned to fit the grant dreams and schemes of employment management that wants its hands at the helm of a superbank.

One need only look at the capital markets to see that the System is continuing, even to this hour, to have funds at a rate that is just a little above the Government's own cost of funds. The capital markets, therefore, do not believe that the System has to be run through a central entity in order for investors to receive a return on their System bonds.

Grassroots held a meeting recently, and at that meeting we had members and people to gather in Des Moines, Iowa. And this meeting was attended by representatives from each of the 12 farm credit districts. Their express purpose, Mr. Chairman, and gentlemen, was to discuss new legislation. The consensus we reached on that occasion was that any comprehensive Farm Credit System legislation in the 100th Congress should include the following points. And I may ask you gentlemen in the Senate to look at page seven and eight. In the interest of time, I will not read these, but these are the conclusions that we reached, and they are part of my testimony.

In addition to those things that we see there, we believe that other things are needed. We think that the Congress, or we believe that the Congress should enact a strengthened borrower bill of rights. The right to a meaningful and defined forbearance policy by the Farm Credit System including a right of appeal within the Farm Credit System of a denial of forbearance.

Item two: at least 30 days written notice before a foreclosure action is filed against a borrower of the Farm Credit System with an opportunity for the borrower to get current on his loan, in which case foreclosure proceedings would not be filed.

Number three: an opportunity for a meaningful appeal of a decision to file a foreclosure action within the Farm Credit System before legal foreclosure proceedings are filed.

Number four, an opportunity for a meaningful appeal of a decision to file a foreclosure action within the Farm Credit System before these things are filed.

Number five, a borrower of the Farm Credit System should be able to have access to significant documents in his loan file at the Farm Credit System including the Farm Credit System's current and prior appraisals of his real estate or any of his other assets.

Finally, let me say that if, and I do say if, finally that if during this Congress it becomes necessary to utilize appropriated tax dollars to aid the System's institutions, it will be imperative for this Congress to make sure that that does not become an excuse for refashioning System banks and institutions into a central entity, or diminishing shareholder ownership.

Indeed, if Federal funds are needed, they should be lent directly by the Treasury to individual banks in the System on the basis of demonstrated need. In conclusion, Mr. Chairman, let me thank you on behalf of the members of Grassroots for your noteworthy and exceptional leadership in the Congress in protecting the cooperative principles on which this Farm Credit System was founded, on which it once prospered and which it should be allowed to continue. Thank you so very much.

Senator BOREN. Thank you very much for your comments. I obviously was in full agreement with several of those from whom you quoted and cited. I think your statement is an excellent one about making sure that as we craft any solution, or bring any additional Federal resources into the System, that we make certain at the same time that this is not used as an excuse for totally changing the original purposes and the way the System has functioned so well in earlier periods.

And I appreciate all the comments that you have made.

Mr. HOLMAN. Thank you, sir.

Senator BOREN. I am pleased that the chairman of the full committee, Senator Leahy, has joined us, and I said early this morning, Mr. Chairman, that both you and the Majority Leader had indicated that dealing with the farm credit crisis is a real priority, and as soon as this subcommittee comes forward with its recommendations, that it's a matter that is going to get speedy attention from the full committee, and that we have been assured as well by the Majority Leader that he intends to place it on the agenda for the full Senate as soon as we can get it there to him for action. We would certainly welcome any comments that you might have at this time.

The CHAIRMAN. I will be very brief, Mr. Chairman. I do have a statement and some questions for the record, if I could have those included.[1] In our first meeting, Senator Lugar and I were talking over some of the major issues facing us, and farm credit, I think we all agree, is a major issue. If I were told today that I could wave a magic wand and put into place any kind of legislation I wanted, I'm not sure just what that would be.

I asked Senator Boren if he would chair this subcommittee. In the Senate, we felt he did not have enough thankless jobs. He is chairman of the Intelligence Committee at this time, too. But with his expertise as former Governor and his knowledge of credit issues he will bring a complete report back to the full committee. I must say you have three extraordinarily able people here: Senator Boren, Senator Lugar, and Senator Bond. The reason I dropped by was to say how very important this is, and whatever we can put together will go, I would hope, on a fast track in the committee.

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[1] See p. 241 for the prepared statement of Senator Leahy.

And another thing—these tables are only temporary. I meant to tell Rudy Boschwitz that before the hearing.

Senator BOREN. I told him, Mr. Chairman, to craft bipartisan solutions, we are going to move the Republicans and the Democrats a little closer together on the farm credit issue.

The CHAIRMAN. I will tell you very, very briefly why this is. I remember my days, and Dick, you and I were there about the same time, as a brandnew member of the committee. We sat way down at that far end, and we would see Herman Talmadge, Jim Eastland, and Milton Young at the end of this table. And Herman Talmadge had a big cigar, so it made a smokescreen. From that far down, you couldn't see or hear what was going on anyway. I want to bring people closer together and I also want both the chairman and the ranking member of the committee and the subcommittee to sit up here at the top of the table.

We are still working on the new tables.

Senator BOREN. Mr. Chairman, it is good because the junior members of the committee could not even see the chairman at the previous time.

The CHAIRMAN. Or the witnesses.

Senator BOREN. But, of course, I remember my first experience coming in when Senator Talmadge was chairing the committee. I kept trying to get his attention. I offered an amendment, and he had said all in favor of that amendment, and there were about four ayes. All opposed, and I think he himself said no. Then he said the noes have it. I kept trying to get his attention.

The CHAIRMAN. My kind of chairman.

Senator BOREN. We were two amendments on down the line when I finally, from that point you were describing where you could not get the chairman's attention way down at that end, got his attention. I said, "Mr. Chairman, it sounded to me like there were more ayes than there were noes. I would like to have a"—he said, "you want a rollcall on your amendment?" I said, "yes, Mr. Chairman, I would."

So he starts calling the roll in which time he voted 12 proxies all no, and he said, would the Senator like to ask for anymore rollcall votes. And never again, Mr. Chairman. [Laughter.]

Senator LEAHY. Dave, thank you for doing this, and Dick and Kit, thank you for being here, too.

Senator BOREN. We appreciate your coming by to express your interest, and we know we have the full support of the chairman and the committee as we proceed on these deliberations.

Mr. Holman, you have talked some about the capital assessment regulations. Do you believe that they should be completely rewritten to ensure that no institution would be assessed to the point where its own future viability would be threatened?

Mr. HOLMAN. Yes, sir, I do. There is more than one way to centralize a system. If all of the institutions are brought down to zero, they are already under the control of the FCA and its people. So without passing a law, it can be centralized simply by bringing their funds down to zero.

Senator BOREN. I presume you are not opposed to essentially the cooperative nature of the system or to some sharing.

Mr. HOLMAN. Not at all.

Senator BOREN. But just so we put in some protection and make sure that it is not drawn down to threaten the viability of the institutions that are making the transfers.

Mr. HOLMAN. Absolutely. Absolutely. I have never discussed or heard it discussed in my presence anybody that ever objected to that which we have already agreed to.

Senator BOREN. Let's say that a property is acquired through a foreclosure type situation. Then let's suppose that it is going to be leased out. Would you believe that the previous owner of the property should have some preference in any kind of a lease-back situation?

Mr. HOLMAN. I would think in most instances, yes, sir.

Senator BOREN. What about the regulatory accounting principles, the so-called RAP? Do you believe that the FCA is following the intent of Congress with respect to the manner in which they are using these accounting principles?

Mr. HOLMAN. I certainly do not, and these two court rulings, that I have as a part of my testimony, attest to that fact. The courts have so determined.

Senator BOREN. Senator Lugar, any questions?

Senator LUGAR. I have no questions.

Senator BOREN. Senator Bond?

Senator BOND. Thank you, Mr. Chairman. I would just ask very briefly, Mr. Holman, do you think there were problems caused or was a direction improperly set in the 1985 enactments? Do you feel there is a problem with the law as passed by Congress?

Mr. HOLMAN. In 1985?

Senator BOND. Yes.

Mr. HOLMAN. Yes, sir, I do.

Senator BOND. What problems do you see and what changes would you recommend in that?

Mr. HOLMAN. I would certainly think that the Capital Corporation should be, as soon as is possible, closed out. You have made provisions to close it out in the year 1990. But it ought to be closed out as soon as is possible, and again, let me repeat that assessments ought to go, or contributions or loans or whatever—and let me clear that up. We certainly believe that any money, if any money is spent, ought to be on a loan basis, whether it came from within the district or whether it came from the Government, but it ought to be paid back. And certainly if this is done, then, this would allow for the money to flow directly from where its source is to the area where it is needed, and certainly this would be apportioned.

In addition to that, as I've indicated though you all did not authorize the FCCA, we certainly believe that the FCCA should be sun-setted at its earliest possible time.

Senator BOND. There were some discussions this morning about problems that arose some time ago back after the 1971 act, when the different appraisal value was instituted, and borrowing was permitted to go up to 85 percent. Are there changes which should be made by Congress to prevent problems such as we face now? Should we establish more accountability somehow in the System? How can we best legislate to avoid future problems?

Mr. **Holman**. I think I will be answering your question. We certainly do not favor the 80 or 85 percent. We certainly believe it ought to be about a 65 percent of the appraised value, and if that is answering your question I have understood it. If it is not, then I'll try to do better.

Senator **Bond**. Are there any other suggestions that you would make?

Mr. **Holman**. Yes, sir. In the matter of local control. Local control has been used greatly this morning, and I want to compliment this subcommittee, and especially its chairman, on the excellence of those of who have testified today. Of the hearings that I have been to over the years, this has been the most knowledgeable group that I have ever heard, and I am very much impressed with that which they have been doing.

So as we view it, local control needs to be thoroughly understood. At the association level in whatever bank a man is a borrower, he as a stockholder has a voice in the election, not of part of a board, but of all of the members of his respective board. As a comparison, let me suggest to you that if we had Ford, GM, and Chrysler, and we had on each of the boards there two members from each of these three organizations, you would see that somebody would be in great trouble all of the time because four members would outvote the two members all of the time, and there would be chaos and catastrophe. So local control can only be enacted as a particular group in any of the corporations has absolutely the right to elect every member of his respective board. Then they are accountable to him. As it stands, they are accountable to nobody way out yonder. So you would never have a successful operation as long as we do not have the opportunity to elect people and make them accountable to us. This is one of the basic reasons why we are in the problem we are today.

Senator **Bond**. Thank you, Mr. Holman. Thank you, Mr. Chairman.

Senator **Boren**. Mr. Holman, I certainly appreciate the comments you have made. You have tested my ability to be an impartial chairman with the statements that you have made because I have been tempted to nod in agreement, or demonstrate enthusiastic agreement with many of the comments that you have made. We do have to find a way, as was said this morning, to get off this path toward self-destruction.

We are into a cycle that if not altered and altered quickly is going to destroy the system. We are going to destroy the concept of local control. We are going to finish the destruction of the capital structure. And we are no longer going to be able to help farmers with long-term sources of credit at reasonable rates of interest through a system operated by farmers themselves at the local level where they have a knowledge of the people with which they are dealing.

I think that it is imperative that we get on and act as quickly as we can, and your testimony is very helpful and challenging to us in that regard.

Mr. **Holman**. Thank you, Mr. Chairman. I am grateful for having had the opportunity to have this appearance here today.

Senator **Boren**. I think Senator Boschwitz has been moved to make a last comment here.

Senator **Boschwitz**. A very brief comment. I note from your—it is more of a note than a question, and it is not in the form of a question—but I note from your testimony that it would seem to indicate that others rather than people who were in local control of these organizations caused the problems. As I see it, there is plenty of blame up and down the line. I would suggest to you that the fact that the System can continue to raise money within a very small spread over the Government's own cost of money is not evidence that the capital system bleeds so much and the way that there should not be a central entity. I am not suggesting there should be. I think that is probably more evidence to the fact that they think that we are going to act in order to prevent them from being hurt. Thank you, Mr. Chairman.

Senator **Boren**. Thank you, Mr. Holman.

We will move now on to our next panel, the board members of the Farm Credit Administration. In many cases, some of the members are quite new, and we are hopeful that they will be able to assess the problems with a fresh approach and not move us toward the establishment of just another bank with no special form of organization, no special form of mission, that comes seeking help without being prepared to take the steps necessary to service the agricultural needs.

We have with us Frank Naylor, Chairman of the Farm Credit Administration Board; Marvin Duncan, Member of the Board; and Jim Billington, Member of the Board. Gentlemen, we are appreciative of your being with us this afternoon. We have had some excellent testimony this morning including substantial focus on the history of the System, the 1916 legislation, the ways in which the System has functioned in the past, and also the course of action followed by the Government during the Depression and crisis in agriculture and the whole economy in the 1930's, the way that the Government responded at that time, and comparing it with the way in which we have responded or not responded recently during this farm crisis.

We have also heard from several farm organizations and received their recommendations about the direction we should take. We look forward to hearing from you and hope that also you might give us as much information as possible on the scope of the problem as you see it, how large is the problem that we are facing, the dimensions of it to the degree that you can do so, and then, of course, your suggestions for steps that this subcommittee might be able to take.

As I said this morning, the chairman of the committee has indicated that he wants for us to move with speed. Senator Byrd, the Majority Leader, has told me that he wishes to have recommendations on the Senate calendar ready for action by the full Senate prior to the Easter recess. So that there is a very strong inclination to put this matter on the agenda for very quick action, and to move ahead and not wait until the situation deteriorates fully.

Mr. Naylor, we are happy to have you with us and look forward to your comments.

STATEMENT OF FRANK W. NAYLOR, CHAIRMAN, FARM CREDIT ADMINISTRATION BOARD

Mr. NAYLOR. Mr. Chairman, thank you, and it is a privilege to have this opportunity to appear before the committee. We have submitted formal statements, but in the interest of time, Mr. Chairman, I would just simply summarize a response to some of the issues which you have raised in giving the charge to us for this hearing.[1]

Prior to 1985, the Farm Credit Administration really had three primary roles that it was assigned through earlier legislative action. One was to be the policy setter for the System and engage in much of its day to day management policy setting.

Secondly, to become involved as the regulator for the System, and which by and large, they did not have the authority nor the ability to fully carry out. And finally to be the System spokesman for legislative purposes. In effect, perhaps even the System cheerleader, if you will.

The Congress, I think in 1985, very prudently removed two of those roles and returned to the individual banks and their associations responsibility for day to day management and to represent itself in the form of a trade organization or other means with regard to legislative matters. And as crafted, the Farm Credit Administration has a regulator very comparable to the comptroller of the currency with similar authorities.

The Farm Credit System in the last several years has experienced some major declines, and experienced very substantial losses. In 1985 the System experienced over $2.5 billion in losses. In 1986, it experienced about $1.9 billion in losses, and even though the FICB system and the BC system appears to have perhaps reached a low point last June at the end of June and shown some improvement toward yearend, the Land Bank System which ended in 1985 with a $1.1 billion of earned surplus ended 1986 with a negative position of almost $200 million.

The focus of the bulk of the problems in the System today within the real estate lending arm of the System, and it continues to be one which requires serious and very close attention. Mr. Chairman, from a regulatory perspective, there are four essential operating problems which have to be dealt with before the system is going to be able to regain its strength and viability as a principal lender in American agriculture as we believe it should be.

Senator BOSCHWITZ. Are you following your prepared statement here?

Mr. NAYLOR. Yes, sir, loosely. It tracks. I am sorry, Senator.

Senator BOSCHWITZ. You are not answering the questions as you said you were going to, and now you are not following your prepared statement.

Mr. NAYLOR. I am tracking, Senator, with the financial condition and the four principal problems, which is just what I was getting ready to start on, if I may. I was trying just to condense those, if I may, but I will track directly if you prefer.

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[1] See p. 298 for the prepared statement of Mr. Naylor.

I was going to page two, System Problems—Regulatory Perspective, sir.

Senator Boren. It is all right to summarize, but if you could kind of go in order, please.

Mr. Naylor. I will do so. I will track with you.

Senator Boren. We have to get two panels in by 4:30.

Mr. Naylor. Yes, Senator. Let me very quickly, then, summarize the four problems. First and foremost is the problem of nonaccruing loans which total about $7 billion. There are major efforts in the System to provide for loan restructuring, but it varies widely from district to district at this current time. The most notable, Senator, being in the St. Paul district at the moment which you will hear more about later this afternoon.

But it still represents a very substantial System problem which has to be resolved. Secondly, the continued high cost of System overhead which has remained very close to its peak level of several years ago, and does require significant change and improvement if the costs to borrowers are to be brought into line.

Third, the continuing cost of high debt that continues to pose a burden on the System. Some of it will remain on the books till 2003, and finally, the problem, I think, you saw reflected here in the last witness, the problem of member relations and relationships of individual borrowers and their relationship with the System.

I think very quickly, Mr. Chairman, with regard to the question of legislation in 1987, I think it is the view, and individual members, I think, will speak for themselves that unless the litigative situation improves and other internal problems are resolved promptly, particularly with regard to collateral sharing and internal sharing of resources, that the likelihood of legislation being required during the course of 1987 is quite high. Included in that, we believe, would likely be involved some form of restructuring to deal with the operating problem. While hard cash may not be necessary, it may be necessary to deal with the two fundamental issues of stockholder security and investor security which may well be able to be handled by instruments similar to guarantees. Certainly some sort of legislation appears to be highly probable. There are basically two options and two extremes which we as a regulator, I think, have a prudent responsibility to examine.

One is the one that you heard about just a moment ago from the earlier witness, and that being a centralized system in which you essentially have a very large national nonbank bank. As we have looked at the various options, however, the other extreme is what we have characterized as decentralization in which heavy emphasis is put on local control and on the local association structure, and you move to make it possible for them to provide a higher quality of service and to do so on a very competitive fashion throughout the system for the benefit of producers.

While there are a good deal more details with regard to that general notion and option, Mr. Chairman, by and large it appears that that general thrust has a broader base of appeal and support as far as congressional examination and System examination and their associations than the other extreme.

With that, Mr. Chairman, and in the interest of time, I would stop at this point and would be delighted to take your questions. I understand the tight schedule. My colleagues also have statements submitted. You may want them to comment before we begin your questions.

Senator BOREN. I think, Mr. Naylor, we might ask for some brief comment from Mr. Duncan and Mr. Billington, and then we will open up the questions to the entire panel. Mr. Duncan.

STATEMENT OF MARVIN R. DUNCAN, MEMBER, FARM CREDIT ADMINISTRATION BOARD

Mr. DUNCAN. Thank you, Mr. Chairman.[1] The System is in a weakened condition. The System also has significant problems remaining in the land bank portfolio, as Chairman Naylor has indicated. The System has been relatively slow, in my judgment, in getting its arms around those problems. It is hampered by a variety of lawsuits and differences of view as to the role of the Capital Corporation, which the Congress had crafted in the 1985 amendments to serve as the workout bank for troubled assets in the System, and as a vehicle for providing financial assistance to weak institutions within the System.

If these problems are not resolved very promptly, the System's still considerable resources will not be sufficient to deal with this problem, and the very real possibility would exist, then, that collateral deficiencies could appear in a number of banks within the System during the course of 1987, and that some institutions might utilize fully the RAP accounting methods that are available under the 1986 amendments and still find that they would have impaired their borrowers' stock under RAP.

So there is a heavy burden on the System to fully utilize its resources effectively and efficiently. But, the possibility exists if they are unable to do that that more adverse problems may arise. The problems may mount and that legislation may become necessary as Chairman Naylor has indicated. With regard to the structure of a system that might emerge, it is my own professional judgment that a Farm Credit System crafted around district banks and lending associations makes more sense, has broader acceptability and better accountability to the stockholder owners of the System than does a national bank structure.

With that, let me close my prepared remarks and ask that my prepared statement be entered into the record. You have received them, I believe, and I would be pleased to answer questions.

Senator BOREN. Right. Without objection, we will enter the prepared statement into the record.

When you say "district," do you mean also including local?

Mr. DUNCAN. I am sorry. I did not hear.

Senator BOREN. Do you include local associations as a part of the district?

Mr. DUNCAN. Yes, I said crafted around district banks and lending associations, local lending associations.

Senator BOREN. Thank you. Mr. Billington, we welcome you, a new member of this Board.

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[1] See p. 308 for the prepared statement of Mr. Duncan.

STATEMENT OF JIM R. BILLINGTON, MEMBER, FARM CREDIT ADMINISTRATION BOARD

Mr. BILLINGTON. Thank you, Senator Boren.[1] It is certainly a pleasure to be here, Senator, and Mr. Chairman and other members of the committee. You have heard about the problems. I would like to put a few numbers on them, if that would be appropriate. System entities are losing $1 billion worth of business each month. The 25 percent of the System's portfolio is in nonaccrual loans or high risk assets, an increase of 10 percent since December 31, 1985.

You have heard about the image problem. We have the System in a rather steep gridlock due to lawsuits between System entities and the Capital Corporation and the FCA. As you well know, the 1985 and 1986 amendments, as Congress envisioned them have enjoyed a very rocky and a difficult implementation. The FCA is dealing with 52 lawsuits as of February 6, 1987.

Barring resolution of these lawsuits, I see no possibility that the System can muddle through this year without some type of Federal assistance. If this System is to survive, many important and difficult decisions must be made in the near future.

It seems that everyone has a solution. These solutions involve restructuring, asset/liability management, policymaking, and law and policy to regulate the System. Discussions include every possible scenario from centralization of decisionmaking to less centralization, and every possibility in between.

I will say that the basic structure and status that this System should maintain is it should remain a cooperative system. There are many persons today that feel that this cooperative status should no longer be maintained. If it is removed, and I sincerely hope that it will not be, Congress will be asked in a very short time to relegislate a new credit system on a cooperative basis because the farmers and ranchers in rural America will demand it.

In my opinion, we should look at the 1971 act as amended. I think that has been talked about today, and I will just cover it lightly. The act allowed Federal land banks to change the appraisal standards. You know they can make 85 percent appraisals. It also did some other things. The act also authorized variable interest rates which allowed the Federal land bank management to have less pressure in order to match securities to their loans. This was a serious mistake. The legislation also permitted the Federal land banks to delegate authority to the FLBA's to make loan commitments. Not only did they make the loan commitments, they did the appraisals and closed the loans. This authority has been abused.

The law addressed many other issues such as loss-sharing plans, consolidated, system-wide bonds, and joint and several liabilities. It allowed the FCA authority to delegate many of its powers to the district banks. Of particular note, was the authority for the banks to examine their own associations. This was a mistake, and has been corrected in the 1985 amendments to the act. Many of the powers of local associations that existed prior to this act were lost due to the district banks' authority to approve all policies of the local associations. If you approve the policies, you run the association.

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[1] See p. 311 for the prepared statement of Mr. Billington.

Surplus in the System is in the locally managed production credit associations. Of the $1,362 million in unallocated surplus in the System, the PCA's control $1,081 million, or 80 percent as of December 31. If all this capital were to be assessed according to FCA regulations, the PCA's will have to charge their farm-borrowers an additional $120 million annually in interest. They are going to charge their borrowers an additional $120 million in interest to cover the loss of this capital. That is the reason that they are suing the System, and that is the reason many of the lawsuits are there. All the capital is in the PCA's. They are filing suit to keep that money. The reason they are wanting to keep it, of course, is as I have stated: they don't want to pay higher interest rates.

The huge losses are being suffered in all 12 banks. The big losses are in the Federal land banks. I think St. Paul had $318 million in losses; Columbia, $292 million; Springfield, $27 million; Baltimore, $68 million; Louisville, on and on and on. They all had losses. All 12 banks had losses last year. Some banks' losses have increased dramatically.

The Bank for Cooperatives and the Central Bank for Cooperatives seem to be on track. Recently I visited a California Federal land bank which I was told had been examined by the FCA, the Sacramento FLB, Price-Waterhouse, and the Capital Corporation all within a short period of time. I was informed that other associations have experienced these same reviews plus scrutiny from the General Accounting Office.

This is a lot of service that I doubt that farmers can afford to pay. We cannot paper-shuffle or examine or review our way out of the problems we are facing. More importantly, many well-managed associations do not need these multiple reviews. Once FCA gets around to finding out who they are and where they are at, maybe we can reduce this costly paper work and work overload.

Somehow we must figure out a way to stem the loss in volume. Reducing overhead expenses is a solution, is part of a solution. Some of the costs are too high. They need to get their income in line with their costs. Many of the association mergers, particularly on a districtwide basis, have materially hampered local decision-making, director input, and services to members. Associations are finding themselves buried in many ill-founded, unneeded policies and rules which tie their hands in loaning and collecting money.

Some paper work and loan servicing requirements are unbelievably complex. While immense, these problems are certainly not insurmountable. We need to, again, get the stockholder and the local people involved in the management of this System. I think we need to try to reduce the waste in the System. The local managers were the people who helped start the System in 1934 to make it what it is today. This System must realize that the glory of yesterday has passed and that the income is going. The goodwill has been bruised, and the quality of the loans has continued to deteriorate rapidly.

The FCA must be given time to reach its appropriate status as a competent arm's-length regulator of System entities. If we can accomplish these goals, then I think the System with financial help from the Government in some form, and where absolutely needed, can survive. I thank you very much for this opportunity. I would be happy to entertain your questions, Senator.

Senator **Boren**. Thank you very much, Mr. Billington. I think that the Board is going to profit from your own long experience in the System, both as a borrower and on the lending side, your leadership in a local association, and your own experience with the System. I just would say to the other two members of the Board, I know you will profit from listening to Mr. Billington, and if any of you might have a sneaking suspicion by now that Mr. Billington has roots in Oklahoma which leads me to make those comments. He seriously does bring a great amount of expertise and experience to the Board. I know we are going to profit from it.

Let me begin with questions for Mr. Naylor, and then we will go around to my colleagues. I think any should feel free to address questions to any members of the panel. In view of the court cases regarding the Capital Assessment regulations, in particular the most recent decision in Springfield, are you preparing to rewrite the Capital Assessment regulations in order to alleviate these lawsuits.

Mr. **Naylor**. Mr. Chairman, the Capital Assessment regs were still and are out in the final comment period. They are still subject to some adjustment and have not been issued in final form. We are, in addition, anticipating appeals of the *Springfield* decision. As you are aware, there has been a divergence of court opinions in both directions on many of the litigative actions that have been involved, and many of these lawsuits have been more directed at the Capital Corporation than at the agency itself.

We as a Board are always looking to clear these regs up, and I think we will be working to do so so they can be effectively put in place.

Senator **Boren**. So you are looking at the impact of these decisions upon the final form that the regulations should take?

Mr. **Naylor**. Yes, Mr. Chairman. We are working with our own counsel and the Justice Department as well as some of the System counsels that are involved in these cases to resolve that.

Senator **Boren**. Let me bring you to the provisions of the 1985 Farm Credit Act, specifically section 4.28 which, of course, deals with the certification which must be made by the FCA before the Treasury is required to determine whether or not to infuse Federal funds into the System. As you are aware, among the facts you must certify, are whether or not the System has utilized all available capital surplus and reserves as envisioned by the amendments.

Also, you are to pass judgment upon whether or not System entities can offer credit to farmers at reasonable terms, especially in light of the Capital Assessment regulations. Considering especially the lawsuits that are involved, and the fact that at least for quite a period of time you are not going to be able to have access to some of the funds from some of the districts, do you envision a scenario in which in the near future the FCA will be able to fulfill the requirements of section 4.28, subsection (j), and certify to the Treasury that financial assistance is necessary?

Mr. **Naylor**. Mr. Chairman, my own candid response would be that under the current circumstances and with the 1986 amendments allowing the use of regulated accounting, that the requirements of the law which would lead us to certify could not be met in 1987 or perhaps even 1988. However, as we have indicated in our testimony, we believe that if litigation continues, and the internal operating problems continue, some sort of legislation may well be needed which might include some form of assistance, albeit it may not have to be hard capital.

Senator **Boren**. Let me ask your two colleagues whether or not that they feel that they would be able to certify, at this time, that the System is in need of financial assistance, based upon the fact that resources are tied up given the lawsuits that are underway and all of the circumstances we now face.

Mr. **Duncan**. Mr. Chairman, at this point, I would not be able to certify that although one has to keep an open mind in regard to this as the year wears on. We have to watch very carefully what the condition of the System institutions are on their quarterly financial reporting cycle, and how well and effectively they are able to pull together and utilize their resources, and the effectiveness of RAP accounting.

While I could not at this point indicate they have met those requirements under the 1985 law, I certainly am watching that condition very carefully.

Senator **Boren**. Mr. Billington, do you think we are at, or close to, the point in which certification could be made to the Treasury that the System is in need of assistance?

Mr. **Billington**. Senator Boren, I think we are very close to the point where we need to very seriously consider this, get the numbers around us, figure out how many of the PCA's that are going to withhold their capital, and how long these lawsuits are going to be in place because we only have $1.4 billion left in the surplus account in the System. And we are losing money at the rate of $400 million plus each quarter so we do not have very many quarters to play around with, and we cannot lock this System up at any point in time.

I think that it is imperative that we begin to get our arms around our System out here and start thinking very seriously about asking Treasury to certify for help.

Senator **Boren**. Mr. Naylor, is it not dangerous for us to continue wasting time under the theory that we might be able to overturn lawsuits, given the unfavorable outcome in the most recent case? The second question that follows on that is has your staff prepared a contingency plan for dealing with the request to the Treasury if it becomes necessary, and what are the dimensions of this contingency plan?

Mr. **Naylor**. Mr. Chairman, we are working with the executive branch in providing Treasury Department information on the System as we have with Members in the Congress, and are prepared to work with the System. One of the major fundamental changes of the 1985 act, however, was to take us out of the role of being the legislative proponent for the System, and the System itself apparently has a legislative group or groups working to evaluate what structural and financial needs they may have.

We intend to be fully supportive of your subcommittee, Mr. Chairman, and of the House and of other Members, in providing technical support and advice on the issues of what the options are and what may need to be done.

It is our view, as we have indicated that unless some significant changes occur soon, we are looking at a fairly tight timeframe for needing some legislative consideration and action.

Senator BOREN. Let me ask specifically, are you, however, preparing for this? I understand that it is not necessarily your role to be the legislative advocate, but it is necessary for you to certify as to the need under the law if the System is in need of help. Are you preparing contingency plans for this eventuality?

Mr. NAYLOR. We are evaluating options both from the standpoint of legislation and from financial perspective of what the System's needs might be. Our own financial model we expect to have through the end of this year available in about 30 days as is the operating system itself.

I would reiterate, Senator, Mr. Chairman, that it is our view, and certainly my view, that with the 1986 amendments providing this opportunity for RAP, and the substantial resources the System still has, that meeting that 1985 legal requirement for certification might be well into the future even though more prudent action might be called for sooner.

Senator BOREN. I would hope that if you felt more prudent action would be called for sooner, action that goes beyond the technical legal requirements for issuing a certification, that you would make known those findings to this committee as soon as possible. Do you believe that it is necessary as an independent agency to gain approval of the Treasury Department or a favorable nod from the Treasury Department before you make any certification of need or before you come to this committee to indicate that you believe we should be preparing a plan even if the legal background for certification cannot yet be met?

Mr. NAYLOR. Senator, absolutely not. The law provides very clearly that we certify to the Treasury. Treasury then makes it own determination whether it would ask for an appropriation. I think the issue here is not so much the certification process, but what needs to be done to ensure the System is actually providing sound and substantial credit and that any solution that is fashioned has to deal with the operating problems as well as financial problems in some sort of coordinated fashion if this System is to serve the needs of producers.

Senator BOREN. Do you Mr. Billington and Mr. Duncan both concur that this Board not only has the power but the responsibility to act independently without waiting to receive any kind of approval from Treasury to certify as to need?

Mr. DUNCAN. We have a responsibility to assess the condition in the System and make a judgment on it.

Mr. BILLINGTON. We do have that responsibility, Senator.

Senator BOREN. Well, I would urge you, again to do so. As I have said, I think one of the real problems, and I hear this from so many people, is that someone must be in charge of this System. We have a System that is obviously in trouble. Someone has to feel that they have the principal trustee relationship for looking after its well-being. I would feel that we had betrayed our obligation to protect the System if we wait weeks and months down the road for further studies or further models before we admit there is a problem. We have gone to creative accounting. We would already be underwater if we had not gone for creative accounting that no one else in the world was allowed to utilize.

We simply have been like the emperor without clothes. We have papered the problem last year. It is time for us to admit that. I would say that I would hope that the Board would not hold back in sending to us specific recommendations for we all know we need a capital infusion. There is not one person that I have talked to that thinks we do not need a capital infusion. Tell us how much. Tell us soon. Tell us your recommendations for getting it done, and then tell us what reforms you think ought to be made in the System for getting on with it. You know we are not going to play ring-around-the-rosey around here. If we cannot get the facts out of the Board, this committee is going to move forward itself. If we have to get the bill out there and take it up on the Senate floor while you are still working on models to save the System, by golly, we are going to do it. We are not going to sit by and let this thing go the way we did last year and the year before of papering over it and being unable to do deal with the problems.

It is on the agenda, and I would just urge you to get with it, give us the information that we need as quickly as possible. Let me go on to another matter on which I also have mild feelings. [Laughter.]

Senator BOREN. When we took up the Farm Credit Act Amendments of 1985, included was an amendment which I offered along with several other Members which prohibited district banks from charging associations whose stockholders voted against merging with other associations a higher rate of interest, or assessment, than that charged to like associations.

We thought we had made it perfectly clear. I do not know how it could have been made anymore clear, both in discussion and in the language, that so-called disapproving associations would not be charged a higher rate of interest in any event under any circumstances.

However, the FCA regulations relating to this amendment permits farm credit banks to charge different rates of interest, prices for services and financial assistance to disapproving associations so long as they can back it up with "financial considerations," which if I have ever seen a loophole wide enough to drive 10 trucks through, that is it.

Now that is a clear violation of the intent of Congress. Why has the intent of Congress been so flagrantly violated.

Mr. NAYLOR. Mr. Chairman, I do not think there was any intent on the part of the agency to do so. The fact is that all associations do receive some consideration by their district banks on the rates that they are charged based on their situation.

However, clearly you intended not only on this but on borrowers' rights to put some very stiff changes in place in dealing with those rights, and we agree and concur and commend you for those, and intend to see that they are carried out. There needs to be some flexibility, but it should not be so broad, as you put it, to drive the truck through the hole.

Senator BOREN. So I assume from your answer that you are looking into this matter and are going to review any charges to disapproving associations that now are paying higher rates of interest or higher fees for services?

Mr. NAYLOR. Yes, Mr. Chairman. As you probably are aware, this Board has taken a much different view than our predecessors on mergers and all other similar actions revolving around borrower rights that I think are very comparable to your own views on this matter.

Senator BOREN. Well, I am reassured to hear that, and I will say that I suppose my fire should have been directed, to some degree, to your predecessors.

Mr. BILLINGTON. Senator, there is one thing that is important in this issue. Most of those associations which have been merged are in such bad shape that their credit quality is lower than the others. So they are the ones that should be charged the higher rates.

Senator BOREN. They even are in worse shape than the ones that have mainly remained independent.

Mr. BILLINGTON. They are in a lot worse shape and their costs are a lot higher than the others. So that could be a problem in certain areas, but we are on top of that.

Senator BOREN. Well, I have never seen a course of action followed as was followed back during the course of some of those merger elections in which local associations were absolutely intimidated. Nothing in the American system that I know of has ever been allowed to function in that way, so I am glad to hear that this is something which you are going to look at very carefully.

It would also be helpful if you would provide the subcommittee the salaries and the value of benefits of the chief executive officers of all the Systems' entities, the Farm Credit Corporation, the Farm Credit Capital Corporation, the CEO's of the district banks, and so on, particularly as it focuses on what has happened to those compensation packages at the 37 district banks as the cap was lifted in 1980.

Mr. NAYLOR. We will provide it for the record, Mr. Chairman.[1]

Senator BOREN. We would appreciate that very much. Again, before I turn now to Senator Boschwitz, I just want to urge that we press ahead. I realize there are certain responsibilities that you have, that there is some diffusion of responsibility within the System. We all understand that. But I do feel that this Board really ultimately must be the ones who come forward and gives us the kind of information that we must have to develop a plan that will put the System back in a position to get rates of interest down to reasonable levels so farmers can survive, so we can stop the loss of $1 billion a month worth of business to the System, so we can stop the flight of the higher quality borrowers out of the System, and so that we can learn from, I think, the very beneficial experience of the 1930's when the Government stopped this cycle because of exactly a situation: high interest rates, the flight of quality borrowers, interest rates on remaining borrowers so high that they can't pay, more foreclosures, more fire sales of assets, and more deflation of land values.

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[1] See pp. 106 and 107 for the current salaries for Farm Credit System district bank and Corporate entity CEO's and the 37 Farm Credit bank presidents.

When you go back and read the description, it is just so similar, and yet we had courage and foresight at that time. Those who came before us had the courage and foresight to deal with the problems. They did not resort to RAP's, papering it over, and waiting. I am not even sure they knew about economic models at that time. They knew they were in trouble, and they dealt with it.

I hope we would have the same kind of decisiveness demonstrated, even if you have to come to us and say, our lawyers are not sure we can meet every legal technicality required for certification, but we think the problem is so serious that you should enact an emergency law in the course of which you both provide the assistance and change the standards under which we can certify so you include the certification and the relief in the same legislation. If that becomes necessary, we could move on that basis. Senator Boschwitz.

Senator **Boschwitz**. Perhaps your final comment should be put in the way of a question, Mr. Chairman, of whether or not while they may not be able to exactly or technically certify at this moment if they feel as you do, and I feel very much in sympathy with your strong statement when you got to rapping on the table there. I thought that was well said.

Senator **Boren**. "RAP" is a bad word. [Laughter.]

Senator **Boschwitz**. Pounding. How is that? But even though you may not be technically able at the present time to certify that the System needs some action from the Congress, do you feel that you are approaching that point, and you would be able to say it to us informally in some way?

Mr. **Naylor**. Senator, I, as we have observed earlier, believe that the System still has substantial resources, and there are a good number of things that it can do itself yet including the proper use of RAP accounting that may mitigate substantially if it is done in a timely fashion its requirements for assistance, if any.

However, the view we have expressed here already today repeatedly to the chairman and yourself is that if that does not occur and occur promptly in the next 30-60 days, obviously some other options are going to have to be considered, and we are prepared and will work with this committee and other Members in the other body.

Senator **Boschwitz**. We would say to you that if you want to stay ahead of the curve, Senator Boren has outlined a rather rapid track, and that it would be helpful certainly to us as we formulate this kind of legislation that we had your input.

Mr. **Naylor**. Thank you, Senator.

Senator **Boschwitz**. One of the ways that might be considered with respect to resources is the borrowers' stock, and there has been a great deal of concern expressed recently about the borrower's stock, and whether or not it should be included in the funds available for the self-help kind of efforts and I would like to ask you if you believe that the stock should be drawn down either now or at some future date, or do you believe that the impaired district should freeze their stock value at its current level, and then pay out only that amount when the loans are paid off?

I would like to have an expression from each one of you, if I may, on that.

Mr. NAYLOR. Senator, the 1985 amendments, which I think very strongly reflect my belief, and we worked very closely with you on those and Senator Boren, have provided that any impairment of member stock had to be corrected with hard cash from a neighboring district.

The 1986 amendments changed that materially in that it permitted management at their option to, in effect, make a loan of its members' equity in their stock to itself in lieu of the hard cash from another district. The effect of that was that management electing to use the regulated accounting could indeed use some of the members' stock funds which a number have elected to do.

If they are able to repay the loan to themselves that they have made back on their business plan, no one will be affected adversely. If, however, that is not the case, there are circumstances where members in a liquidation situation could be adversely affected. That was certainly not the objective of our efforts in 1985. It did change it somewhat. That is one of the reasons I think we have to watch the development of the situation so closely on the use of RAP. Marvin?

Mr. DUNCAN. Senator Boschwitz, the Farm Credit Act is very clear with regard to the nature of borrowers' stock, that it is equity capital in the institutions of the Farm Credit System. And indeed, it is by virtue of ownership of equity capital in those institutions that the borrowers control their institutions, as the previous witness so eloquently indicated. So that in liquidation, the borrowers' stock has been at risk for decades and continues to be.

The 1985 amendments clearly made a judgment on the part of the Congress that the surplus, the unallocated surplus in that System, which had been earned by virtue of being able to go to the financial markets under agency status, ought to be used to support the value of borrowers' stock throughout the System and the Capital Corporation was the vehicle for making those assessments and providing those allocations.

Chairman Naylor is correct that the 1986 amendments have provided an alternative option to the management of an institution to choose to put that borrower stock at use in the case of an institution that used regulated accounting to remove for regulatory purposes the impairment of borrower stock.

Senator BOSCHWITZ. Mr. Billington, you might, and I understand what you are saying is that the stock is at risk by definition. I think that is what all of you have said. But there is a great deal of feeling, as you may know, that in the event the stock is at risk, or the leadership of the FCA or the Farm Credit System is going to impair that stock that the best borrowers will take some very rapid flight.

Mr. DUNCAN. That is a difficult problem, Senator, very difficult problem.

Senator BOSCHWITZ. How do you suggest that we reconcile that problem in the event that you say that 5 percent of the equity, 5 percent of the loan, in effect, is going to be subject to some type of removal? That money that they have been paying interest on for some time in many instances, and have never received, and that raised their real rate of interest. In the event that they feel that that 5 percent is at risk, you are going to have a much greater flight, and probably bring about the circumstances that would push the Farm Credit System to the wall very rapidly.

I think it is very important that we reassure the stockholders that we are going to, indeed, protect their interests.

Mr. DUNCAN. Senator, I think that the 1985 amendments have certainly given an indication to the borrower-stockholder that the Congress wanted that surplus in the System to be used to support the value of borrower stock in troubled institutions. Moreover, the legislation provided a mechanism for requesting financial assistance should that turn out to be required.

With regard to my own views on what might be the alternative solution out of what is admittedly a difficult dilemma for the System, I have not fully formulated my views on that. I am looking at a variety of options currently that might be available. I admit that I come from a business background, background, in which I recognize the value of risk capital in an institution, because it causes people to take an interest in the affairs of that institution, and to effectively govern that institution in a prudent and responsible fashion.

I note that in the case of the S&L industry where institutions are in negative capital positions, that those institutions tend to have a tendency not to prudently manage their way back to stability, but to take even more risky management decisions. And, I am concerned about that aspect of having no stock at risk and no equity holders in a system institution.

Senator BOSCHWITZ. My experience, of course, is that if a person has their money at risk that if they can remove it and remove it from that risk, they are going to do so. And that, of course, is the problem. How do you, Mr. Naylor, feel? Do you believe that the stock should be drawn down, or do you believe that the impaired districts should freeze their stocks' value at its current level, and pay out only the amount when the loans are paid off, pay it out in full? How do you think that should be treated? What will the impact on the institutions be?

Mr. NAYLOR. Senator, my preference is reflected in the 1985 amendments which provided that hard capital had to be maintained to protect the value, although the stock clearly is at risk. To do otherwise, would put you in trouble. But I do believe that it is a very difficult issue for the System, and one of the fundamental issues in any legislation that may be proposed is going to have to be a resolution of this stock problem. I share Mr. Duncan's view that some sort of risk capital should be maintained by the owners of the System, but the present approach may not be a viable one if the System is to remain a strong agricultural lender, and the principal agricultural lender. And we are going to have to find some way to remove that as an impediment to sound operations within the System.

Right now you have approximately $4.5 billion of risk capital that is effectively at question as to whether it is being used or not or can be readily made available. The investors obviously expect that it will be, and it has been set up that way. On the other side of the coin, as you recognize and I do, it is a very difficult problem with the individual borrowers at home. Our 1985 amendments attempted to avoid that problem.

The 1986 amendments have changed rules, and offered a district or an association an option to use some of their members' stock value. And one of the principal responsibilities you gave us as a regulator was to insist that if that option was elected by local management that stockholders receive full and complete disclosure so that they had the option to tell their management they wanted it handled in some other fashion if they so desired.

Mr. BILLINGTON. Senator, I would also like to address this issue. I think if we go back and look at the 1985 act there was more participation from the stockholder side involved in that act. At that point in time the market did stabilize. The investors were assured that they were okay. Now, the stockholders thought they were okay, and then here comes the 1986 act which lets the System go into the stock which in one district already has happened.

The stock is less than par in value. What is going to happen? The reason we are having this $1 billion loss each month in volume is because the farmers are still waiting for some signal to tell them that we are real serious about what we are doing up here, and I agree with you, Senator. I think it is time we get serious, and for this reason: It costs more to fix the System if we continue to muddle through like we are doing now than if we will go and try to cure the Systems problems today and start forward. Then we will not have the borrower flight that we are experiencing, and we will have people out there who have the ability to say, look, this thing, they are serious about it.

They are going to not only take care of the investor. They are going to take care of the farmer, and so if this be done, then I think we should act very quickly to curb this problem that is totally disintegrating the System. It does not have but a few more months to go at the rate it is going now.

Senator BOSCHWITZ. Well, I am in agreement, and you have answered more directly the question than have your colleagues. I understand what risk capital is having risked a good deal of my own. But I also am a practical fellow, and feel that in the event we don't assure the farm borrowers that their capital is secure that there is going to be an even more rapid flight of the very best borrowers from the System. It may be that some of your colleagues feel that it is good that there is risk capital involved. People take greater interest in it, but people take an even greater interest in their own risk capital, and they do not want to risk it.

So I am confident that farmers' investments in the Farm Credit System is safe, and that Congress will do whatever is necessary to ensure that this stock is protected. It is my judgment that this is an urgent priority and may well be the only way to prevent borrower flight from the Farm Credit System so I will talk with the chairman of this subcommittee, as well, to see if we cannot do something to assure farmers and borrowers that legislation will give them some assurances in that area.

Senator BOREN. Senator Boschwitz, you don't need to talk to me. I share that concern 100 percent, and certainly we will work together, all of us on this subcommittee to try to fashion a solution that makes clear that degree of protection which is so necessary as you have outlined it.

Senator BOSCHWITZ. Otherwise, I think that we would be just saying to the System that we are going to see you in trouble, and this is a sure way to define that trouble will be fast forthcoming. I would like to ask you, Mr. Naylor, about the same St. Paul model. You have been quoted as saying that the St. Paul's district of restructuring is on the right track. There are several elements to it, and I address the question to all of you. No more acquired property. Aggressive resale, restructuring of nonaccruals. You are using shared appreciation mortgages and reducing their administrative expenses by 10 percent.

In your view, is this plan transferrable to other districts, and if so, how much effect would it have on the overall health of the System?

Mr. NAYLOR. Mr. Chairman, Senator, that particular proposal has shown a great deal of promise, and has received very favorable receptions in the St. Paul district. It certainly is applicable and usable in other districts. I believe in one of your later panels the president of that district will give you very specific early results of that effort and some of the positive impact it has had.

Senator BOSCHWITZ. Any of your colleagues have any comments on it?

Mr. DUNCAN. Senator, I think that that has been a most interesting set of alternatives that they have developed in the St. Paul district. I have visited with Mr. Buegler, the president of that bank, and it seems to me that on the loan restructuring side they have some very interesting and constructive alternatives they have developed and are implementing, and even in the case of sale of property, they have been able to do that in a fashion that has supported the land values in that area.

And, of course, that is of benefit to every farmer because it stabilizes the value of his assets on his balance sheet. I won't comment further on that other than to indicate my general support of what they are doing because I know that Mr. Buegler is going to speak more directly to what he has been doing in his district.

Mr. BILLINGTON. One thing I might say, Senator, is it is not so much what they have done. It is how he went about to do it which I really do appreciate. This gentleman went out and involved his stockholders and his borrowers in the process. He went out and talked to the district people. He went out to your local associations up in Minnesota and Wisconsin and North Dakota. He went to the directors, and he laid a program out for these people.

He went out and asked what they would like to do, how could they solve this problem. He has total involvement with his stockholders in this process. It is a bright light to see this occur in the Farm Credit System, and so I don't know what the end results are going to be. I know it is easier to sell the first tract of land than it is the second one. He has made some rapid strides in that area. And we want to congratulate him, and we are watching that very closely, and we are certainly publicizing it to other districts to see if they can handle their problems in the same method.

Senator Boschwitz. I know my friend from South Dakota will want to discuss that. He is afraid they are going to put ads in the Wall Street Journal about selling South Dakota for 4.9 percent.

Mr. Billington. They sold Wisconsin first.

Senator Boschwitz. And North Dakota. The 1985 act, I addressed this to you, for the first time required the directors of the Farm Credit System Board to disclose certain financial information, and for directors with debts categorized as vulnerable the full details of their account, amount owed, interest rates, et cetera, included in the local association's end of the year report. I guess those parts are not so difficult to bear.

I do not have any problem with that, but unfortunately the Farm Credit System has gone a bit further than that. It is also requiring the publication of information on the troubled debt of the relatives of the director, even when they have no financial link at all. This strikes me as really going too far and will do nothing more than embarrass people not involved and prevent people from running for directorships.

Apparently we are experiencing this in the St. Paul district. So my question is simple. Why require disclosure of information that no other financial institution is required to divulge and to give the example, of course, the example that was given to me was a man whose brother lived nearby and another brother, or it doesn't even have to be a brother. It can be a further relation. He lived 150 miles away. That guy had financial troubles, and since in the report the people are not named, there is a disclosure and people would assume that perhaps the brother who lived nearby who they knew had that financial problem. And in the meantime, the guy who is on the board decides he is not going to do this again and subject his family to this kind of an abuse. Why are those kinds of requirements made so stringent beyond the terms of reasonableness, in my judgment, Mr. Naylor?

Mr. Naylor. I would ask my own colleagues to comment also, Senator. But basically the regulations that are in place parallel those that are put in the other banking systems and in the SEC. And indeed, as far as disclosure of the individuals is less onerous than that used by other financial regulators with regard to their institutions.

The reason——

Senator Boschwitz. I was the director of a bank, and I do not believe I was ever asked to disclose. I never had to ask any of my brothers or sisters or father for their financial information. They probably would not tell me.

Mr. Naylor. Senator, under the current regulations of the National Bank Systems, the banking system, as well as the SEC, we very closely parallel almost verbatim the same guidelines that they use for their own institutions with regard to disclosure, the reason being in large measure that this is a borrower-owned system, and the decisions of individual directors very much influence the strength or weaknesses of that system. Marvin?

Mr. Duncan. Senator, the disclosure regulations do, indeed, parallel very closely those of other publicly held financial institutions. In the case of our regulations, we have required that the disclosure to stockholders indicate if there has been a director with a classified loan from that institution during the past year, or if one of his immediate family had a classified loan from that institution within the past year.

The reason for that is very consistent with the concern that this Congress, I believe, appropriately raised in the 1985 amendments. That is that every borrower in this System has equity capital invested in it, and is an owner of this System, and it is a very widely dispersed ownership. Therefore, in the interest of making sure those borrower-owners are fully informed of the management and condition of their System institution so that they can take appropriate judgment as they exercise their right to vote for directors, we have made that requirement.

Senator BOSCHWITZ. Well, I know we need to move along. The afternoon is moving along as well, but if it were on file, it would be one thing. There is a great deal of difference about publishing it and having it on file. We will pursue this point, Mr. Chairman. Thank you very much.

Senator BOREN. Thank you very much, Senator Boschwitz. We are very pleased to have Senator Daschle with us today, a new member of this committee though he is certainly not new to agriculture. He has made a very significant contribution as a Member of the House before coming to the Senate. I know that all the members of the committee are enthusiastic about your joining us on this committee and feel fortunate to have you as a member, Senator Daschle. I recognize you for questions at this time.

Senator DASCHLE. Thank you very much, Mr. Chairman. I have found both yours and Senator Boschwitz' questions very penetrating and very informative for me. Many of them have been answered. I would like to go back to a question with regard to risk that both Senator Boren and Senator Boschwitz were addressing earlier, and ask if you might elaborate as to your views with regard to risk and bondholders? You have discussed fairly thoroughly what you see the risk to be with regard to stockholders.

How would you describe bondholders responsibility in this regard?

Mr. NAYLOR. Senator, I think the key issue that has to be asked here is are we going to continue this System to be the primary agricultural lender, and I think all of us have concluded that that is absolutely essential. If that is to be the case, then you have to have the confidence of your investors to obtain the money to make those loans. Therein lies the basic joint in several liability responsibility of the System. If the investor ever doubted that, our ability to raise funds at competitive prices and pass them on to producers would be lost and probably permanently lost.

Senator DASCHLE. Are you saying this for both bondholder and stockholder in this case?

Mr. NAYLOR. Bondholder was your question, and yes, the bondholder is obviously that issue. The other issue, the stockholder issue, I think has to be addressed separately. There has to be some sort of risk capital in the System. Whether it should be tied to a loan specifically, or as other cooperatives do, you purchase stock to be a part of and access to that, but not necessarily tied as an alternative, for example.

In some fashion we need to resolve and reassure and restore the confidence of borrowers in their stock at the present time, and also to look toward a way to remove that as a major impediment to the operation of the System in the future.

Senator DASCHLE. So how does that translate into practical impact with regard to bondholders today?

Mr. NAYLOR. Practical impact is that that bondholder is 100 percent certain that either directly as joint several liability or with the Federal backstop, those securities will be repaid. That is the only fact. Without that Federal assurance, we would not be in the market today.

Senator DASCHLE. Do your colleagues share that view?

Mr. BILLINGTON. I certainly share that view, and the System now is carrying a reasonably large amount of cash on hand so that if there is a problem, why the cash will be available. So that issue has been addressed, and I feel very comfortable that with the reserves for losses account, and with the earned surplus and with the member stock that is in the System plus all the collateral that is backing up these securities and the cash on hand, I feel that the bondholders probably have no worry at this time, and certainly I have asked some friends around, and they say there is no problem with it. It is apparent on the market that there is no problem.

Mr. DUNCAN. Senator Daschle, I have been a member of farmer cooperatives for some 40 years. People say I must have started very young, and indeed, I did. In North Dakota there is a very similar view of cooperatives to that which you are familiar with in South Dakota. I am still a member of probably about 15 farmer cooperatives and have stock invested in them.

And, my primary concern is not whether they use my stock for purposes of running the business, but whether it is used wisely. And, I think that is the primary consideration for the borrower-stockholder in this System, whether that stock is being put to wise and effective use that will provide future stability for that Farm Credit System institution, so that it can continue to be an effective and reliable lender to American agriculture.

Now with regard to the bonds, the Farm Credit System has issued collateralized debt instruments, and those bonds that have been issued by System banks are debt instruments in the classic sense. That is to say that the bondholder expects to be paid by the institution, that issued the debt, in full and with interest. And if that does not occur, the bondholder has a legal right to go after the resources of that institution. Indeed, given joint and several liabilities in the System and issuance of systemwide securities, the bondholder has a right to go after the resources of the entire System to obtain payment of the principal and interest.

Those who suggest the bondholder ought to take a hit need to understand that the bondholder, because of the nature of the instruments that have been sold, takes his or her hit last after the resources of the System have been exhausted to fulfill the obligation to repay the bondholder.

Now one could conjecture as to whether collateralized debt should have been sold. It was sold. It clearly was of advantage to the System in that it got better interest rates which it could pass on to its borrowers in terms of better credit opportunities. But the reality is that those bonds outstanding are classic debt instruments, and the holders have a legal redress against the System in the event there is a default.

Senator DASCHLE. Of course, the Congress lays out the criteria by which access to those resources can be provided, as they do in any other situation.

Mr. DUNCAN. Senator, Congress has every right to act on that into the future. Probably it would be difficult to change the relationship on the bonds that are now outstanding, and case law would suggest that the procedures that I have described probably are those that would be upheld by the courts on the bonds that are currently outstanding.

Senator DASCHLE. I know that we have several witnesses, and I do not want to belabor this point now, but I think there are the factual considerations and there are the perceptive considerations, and we have to be very sensitive, as well, to the perceptive considerations.

It is difficult to explain to someone in South Dakota or North Dakota that while the stockholders are going to take their lumps and while others will be involved with regard to sharing the risk, the bondholders are free and clear. Regardless of how much legal explanation one can make——

Mr. DUNCAN. Yes, I am sensitive, Senator, to that.

Senator DASCHLE. I really believe that we have a job to do here, and it cannot be overlooked. We cannot simply say, look, they are in a class by themselves. As we address this issue, I am hoping that we can do so with that in mind.

Let me just ask for just a clarification of the chairman. You had indicated that the court case is going to have some bearing as to your schedule with regard to certification. You also have said that it may take 30 to 60 days, and that certification process could begin. Let us assume this court case is drawn out for an extended period of time, what happens then?

Mr. NAYLOR. No, Senator, I think we are probably mixing and matching two different items here. Let me see if I can clarify that. The court cases that are ongoing and the observation we made was that if the System's internal rather complex litigation that is going on as they sue each other and sue us and sue the Capital Corporation, if that type of activity is not moderated rather quickly along with some other internal actions with regard to dealing with collateral and other financial problems, then it was our view that the likelihood of legislation being needed very soon.

Then that was the 30 to 60 days to begin to bring that forward was very real. That that might well have to include some type of financial assistance, albeit not hard capital perhaps. Perhaps guarantees. But the principal concern being to reassure the stockholder that his position is sound and to reassure the investor that he should continue to invest and provide the money to make loans.

Senator DASCHLE. So what you are saying is that the action that you have just alluded to may be something short of certification?

Mr. NAYLOR. My view is that—and Mr. Chairman, I think we need to clarify that. The technical certification may not under the law be appropriate, but other legislative action to get the System back on its feet and stabilized and being the principal lender may very well be appropriate, and it may need to move forward before you and be brought on the table.

Senator **Daschle**. Are you saying then, Frank, that we may move as we have twice now with some action short of certification, but that down the road you still hold out the option of certifying if you see that these legislative remedies fall short of the mark?

Mr. **Naylor**. Certainly that option is there, but Senator, my own view would be, and I would think that you all would share it, that if we are going to deal with this issue, we should deal with it thoroughly, completely, and give sufficient broadness of action to the operating system, the district banks and their associations, and appropriate authority to a regulator to ensure that we do not need to come back to you again on a regular basis. We ought to get this problem resolved once and for all.

Mr. **Duncan**. Senator Daschle, may I comment with regard to the borrower confidence issue. I share the sensitivity that you expressed toward the plight of the borrower stockholder and his or her concern about the stability of institutions in which they are owners, and from which many farmers and ranchers obtain their primary source of agricultural credit.

I believe that those farmer-stockholders ought to find comfort and support in a hearing such as this because this is evidence that the Congress does want to deal responsibly and effectively with the problems in the Farm Credit System.

Senator **Boren**. Let me clarify again what Senator Daschle was just asking about in regard to certification. Mr. Naylor, in your answer you said that, well, action short of certification might be requested, and then you said, I believe the words "other than capital infusion." Now by that, you do not mean that we would not necessarily ask for capital infusion if it were needed, even if you felt we are in this situation where the lawsuits may tie us up for a long time, and that clearly is going to prevent the use of resources, some resources, available within the System.

I would hate to see us in the situation where obviously resources are tied up and lawsuits are going to drag on for months or years as they can sometimes do, where we would hold back either from going ahead and saying we can make the legal certification because as a practical fact, even though hypothetically they might be available, these resources are not available because of litigation, and proceed to certification on that basis.

Or, come to the committee and say, we have concern from our lawyers as to whether we can make the certification, but we feel there is a need. If there is a need for capital infusion, you would not hesitate, would you, to request that to this committee even before you were in a position to make legal certification?

Mr. **Naylor**. Mr. Chairman, we have indicated, I think, several times today that we believe that some legislation may be necessary which may indeed require some assistance, not necessarily hard capital. Perhaps guarantees, for example. What form that takes depends in part on your next panel frankly and what they do with the use of their Capital Corporation and their own resources. Some of the corrective steps need to be sure that whatever you do as a Congress, action is effective in putting the System back on its feet on a long-term basis, not simply putting money on the table which

I am sure is not what you are suggesting either. But to develop a comprehensive solution to this operating problem.

Senator BOREN. Well, I certainly think we ought to have a comprehensive solution, and I have to say that I do not rule out a direct capital infusion, and I believe it may well become necessary. My question is, do you rule out a direct capital infusion if it becomes necessary even going beyond guarantees? Do you rule out asking this committee for a direct capital infusion until such time as you believe you can legalistically make a certification?

Mr. NAYLOR. I do not think we have ruled out any option, Mr. Chairman, but I do not think we have seen any indication at this point that the System, as I think the System may well testify itself, doesn't have considerable ability to deal with its own problems, and it does not necessarily require the type of approach that we are discussing.

Senator BOREN. Well, all I am saying is they are sure not dealing with it to date at all. I mean there is no reduction of interest rates to make them livable or manageable to farmers. There is no diminution of the loss of business at $1 billion a month. There is no diminution in loss to the System and the System is not dealing with it. I mean how long do we have to go? How many more months? How many more years before we admit we are dealing with it?

The farmers don't understand waiting. I am just interested in saving the System. I would again urge you to let us not stand on legalism. When the house of cards all falls down, people are not going to give a hoot about whether or not section 4.28(j) was met. I am going to go out there and stand and say, as the whole thing goes crashing down, that the legal requirements of section 4.28(j) of the Farm Credit Amendments of 1985, the technicalities were not met because in theory we had access to assets but because they were tied up in litigations, they were not practically available. I'll not say that from a legal point of view, we could not give the certification so we could save this System before it went down.

Hearing the historian speak about the judge that was hauled off the bench and farmers, being a law-abiding group, didn't actually hang him, all I can say, Mr. Naylor, is that if you stood on that, and I were in the crowd that hauled you off the bench, I am not sure that I would be quite so lenient as those law-abiding farmers were back in the 1930's. I mean that very sincerely. We have a responsibility to deal with practical solutions.

Mr. NAYLOR. Mr. Chairman, I would not be here talking about the possibility of the need for legislation this year if I was standing on ceremony, and we are prepared and will work with this committee and the leadership of the Congress on both sides of the aisle to deal with this problem. You asked me a technical question. The technical question is probably if you hung yourself by that, you do have that problem. But what we are discussing with you today is that we are not hanging ourselves by that problem, but we are prepared to try and resolve it and resolve it in a way that will get this System back on its feet and in a strong position.

Senator BOREN. All right. I just want to urge you again and to state that this train is going to move, and if this Board wants input into the direction this train ought to go we need it now, because we intend, with you or without you, to begin to address and solve the problems. If we have to go to external sources to gain information about the financial needs of the System in order to address it, we will do so. But we would certainly prefer to get that information from our own Board, and to do so promptly, because we are going to have a bill for markup, I will guarantee you, prior to the Easter recess in this committee.

So, I would urge you to get information to us by then, and if models are not ready, give us however much you can from the models at that time because we are not going to wait on models. We are going to move. I would urge you to let us have however much information you can give us at the time we begin to move.

Mr. NAYLOR. Mr. Chairman, I assure you, you will have our full and complete cooperation and the full resources of any information we have available. You, of course, are also going to be talking to the management of the System who will have a major interest in any steps along the lines you are discussing and has a different perspective on what the requirements might be.

Senator BOREN. Right. Let me just ask one last question and we will move very quickly, and I do not want to be viewed as being overly critical. Mr. Duncan, I have heard reports, and I want to ask if it is true, that in the past you have stated that any Federal assistance provided to the Farm Credit System should be paid for by the reduction in target prices.

Did you really think that, if you said it, and if you said it, do you still think it? Further, if you think it, how in the world can you possibly justify putting the burden on very few commodity groups for the kind of aid that is needed for agriculture in general?

Mr. DUNCAN. Senator Boren, that assertion is absolutely false, absolutely false.

Senator BOREN. That is all you need to say, and I am very elated to hear it. All right. We will go on to the next panel.

Senator BOSCHWITZ. I thought, Mr. Chairman, you were going to pound the table again, but I want to assure you that I am going to be on that train with you, and I would hope that these Commissioners will be as well.

Mr. NAYLOR. Thank you, Mr. Chairman.

Senator BOREN. Thank you.

Mr. DUNCAN. Thank you.

Mr. BILLINGTON. Thank you.

Senator BOREN. It is kind of like the old spiritual, you know, "Get on Board." Let's see. We are now going to hear from Mr. Beesley, Chief Executive Officer of the Farm Credit Corporation; Sam Eberly, chairman of the board of the Farm Credit Services of Wichita; and Larry Buegler, the president and chief executive officer of the Farm Credit Services of St. Paul.

Let me apologize in advance, again, for the fact that we have run behind, and unfortunately all sorts of other things have intervened. The chair is going to have to exit very shortly, but Senator Daschle has generously agreed to stay for a few minutes. He also has a tight schedule, and the ranking member also has to depart very shortly. But we will make sure that the record is completed with your testimony, and I apologize to you that we are running so far behind.

Mr. Boschwitz wants to start with Mr. Buegler if he could first give his comments, and then we will move right along then to Mr. Beesley and then Mr. Eberly.

STATEMENT OF LARRY D. BUEGLER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT SERVICES OF ST. PAUL, ST. PAUL, MN

Mr. BUEGLER. Mr. Chairman, and members of the subcommittee, I am pleased to be here today to review with you the conditions in the 7th Farm Credit District. That is the area of North Dakota, Minnesota, Wisconsin, and Michigan. The seventh district is the largest district in the System with $10 billion in assets as of December 31, 1986, and provides services to more than 100,000 farmers, ranchers, and cooperatives. I joined Farm Credit Services in September 1986 after spending 27 years with Norwest Corporation which is a multi-State bank holding company headquartered in Minneapolis, Minn.[1]

My responsibilities at Norwest over the years included farm management, estate planning for farmers, commercial lending to agricultural producers, and agribusinesses, and in recent years, I was chairman of the board and chief executive officer of six Norwest banks. As an agricultural economics graduate from the University of Minnesota and a banker I have been very familiar with the Farm Credit System for a number of years, and had competed with the System for agricultural loans, participated with them in loans, and also negotiated backup lines of credit for two farm credit districts.

Over the years, I had admired the System which competed very effectively with banks, and had hired a number of their employees who I thought were well-trained and experienced in ag lending. Therefore, when I received the telephone call from an executive search firm looking for candidates for the St. Paul District CEO position, I knew what the issues and problems were in agriculture and at Farm Credit.

After 2 months of talking with the Seventh District Board of Directors and researching a number of issues, I decided to take the position, and I can tell you this afternoon, after 5 months on the job, my only regret is that I did not take the job sooner.

The situation in the Seventh District at the end of September 1986 was a total loan portfolio of $9.4 billion, of which $1.5 billion was on nonaccrual, and at that time we held $222 million of acquired property. Because of declining land values, we made an additional $194 million provision for loan losses in the third quarter, and for the 9 months of 1986 net operating losses totaled $283 million.

This caused the district for the first time to seek assistance of $179 million from other districts to stop the capital impairment in the Federal land bank. This assistance was received after approximately $160 million of financial assistance had been provided to other districts in 1985 and the first part of 1986.

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[1] See p. 315 for the prepared statement of Mr. Buegler.

Our projections at that time indicated that the district would have additional losses in the fourth quarter, and in 1987, we would be faced with our first cash loss ever, and that is a loss before the provision for loan losses.

This expected loss was based upon a projection that our loan volume would go down dramatically. Nonaccruals and acquired property would increase, and that expenses would remain flat. It was clear that something had to be done to reverse those trends. It was also clear that time was running out.

We had to do something bold and quick. For the first few weeks, I traveled across the district gathering ideas on what could be done, and asking questions such as how many of those loans which were on nonaccrual; did we have a good producer with good financial records, and the only mistake he ever made was to be born at the wrong time and had to pay too much for his land. If both the lender and borrower made compromises could we get that loan back to accrual?

I was told that 50 percent of our nonaccrual loans could be restructured to viability. Raising similar questions about acquired property, I was told that if we got creative in our financing of land sales, we could sell 50 percent of our land at or above appraised value.

We revised our forecast for 1987 based upon a 50 percent reduction in nonaccruals and acquired property. The new forecast said if we reduce expenses 10 percent, we could get to break even before loan loss provision rather than be faced with an $86 million cash loss.

That, then became phase one of our recovery plan which was approved by our more than 350 local association service center farmer directors in late November. In December we began communicating the plan to each and every one of our 2,500 employees and prepared them for implementation.

In January, we started our acquired property sales blitz in Wisconsin, advertising nationwide "Buy Wisconsin" for as little as 4.9 percent interest. We set up hot lines to handle the calls, but seriously underestimated the amount of interest that would be generated in farmland. Because of the interest in Wisconsin, we moved that program into Minnesota and North Dakota and Michigan on the first of February.

In the first 6 weeks, we received over 20,000 inquiries on the 2,000 parcels of land that we had for sale. Year to date we have sold over 76,000 acres of farmland out of our beginning inventory on January 1 of 580,000 acres. The amazing thing is that almost 90 percent of that land is being sold to farmers at an average sales price of 5 percent over appraised value with the majority of those sales for cash or at interest rates averaging 8.9 percent.

In January, we moved special credit teams into our service centers to evaluate the nonaccrual portfolios loan by loan. A bottom line settlement was established for each and every one of our 6,000 nonaccrual loans in the land bank and the 2,100 loans in the PCA's.

Approximately 4 weeks ago, we started our restructure program, and of last Friday, had reached signed letters of understanding with 2,350 land bank borrowers and 650 PCA borrowers to restructure their debts. On a percentage of loan volume basis, we have negotiated 37 percent of our nonaccruals to date. Again, we were surprised by the interest of our borrowers that they had in this part of our recovery plan, and now rather than additional losses on nonaccrual loans, we will likely experience recoveries over the established allowances and previous chargeoffs.

It now appears that we will meet by March 31 our goals to reduce nonaccruals by 50 percent, and sell acquired property by 50 percent which we thought would take the entire year of 1987 to complete.

Because of the success of phase one, we are currently testing phase two which will be another series of bold moves to return the Seventh District to financial health. Our new goals will continue our desire to keep the good producer on the land which will stop the influx of acquired property.

At the same time we will continue to sell real estate without driving down land values any further. The culmination of these events will enable us to reduce our interest rates closer to competitive levels for all of our borrowers in 1987.

There is a major problem that we have at the moment, and that is what you had heard earlier is the flight of our very best borrowers. During 1986, the land banks and PCA's lost $1.2 billion in loans primarily because our interest rates were uncompetitive and more recently farmers had become concerned about their stock.

We have still not solved the loss of business, and it would be my hope that perhaps you in your deliberations could reaffirm the congressional intent that I just heard to support the Farm Credit System during these very difficult times. If you can do that, I will assure you that the hard work and the dedication of all of our employees in the Seventh District will continue.

I think you will agree to date that their success has been very encouraging and beneficial to farmers in the agriculture in our four States.

Senator Boschwitz. I am going to yield to Senator Daschle who I know will have some questions. The chairman asked to be excused for a moment. The President is calling him and he always answers those calls. So he is not presently available, but we have discussed your testimony, and as I say, I know that the Senator from South Dakota has some questions, and I would say very unequivocally that we do indeed reaffirm congressional intent to support the Farm Credit System, and support the borrower and his equity and his stock so that we can see them through this difficult period. Senator Daschle.

Senator Daschle. Senator, I would be satisfied to hear the other two witnesses, and then ask as a panel whatever questions I may have. But if you have questions, please proceed.

Senator Boschwitz. No, I have talked about my questions to Mr. Buegler. We are very pleased that he is at the helm in St. Paul. He has very aggressively, as he has outlined, and sought to deal with the problems that our district has. Our district being the largest district. I suppose you must be in the second largest district out of Omaha. I am certainly aware of those problems as well.

But Mr. Buegler, who was with the bank that I dealt with for many years, though we did not know one another well, nevertheless has brought a great deal of energy into the System, and I think that people feel, and quite correctly so, that the St. Paul district is on the move, that the St. Paul district is coping with its problems, that the St. Paul district is making some real progress. I know that you have expressed some concern about some of the ads that appeared. I hope that your concerns were somewhat satisfied when you see that they are selling the land above the appraised value and either for cash or at average interest rate, the majority either at cash or at an interest rate of 8.9 percent because I, too, encountered concern throughout the area. I went back and had a bunch of farm hearings, and they all said we would like to have 4.9 percent interest as well. I think that the farmer does have the option to buy the land on the same terms if he is able to do so.

Mr. BUEGLER. Yes. In Minnesota, if we have acquired property through foreclosure and then sell it to someone, we are working under a law in the State of Minnesota that says that that previous owner has a 60 day right of first refusal. So he has within 60 days to match that offer. As it relates to the 4.9 percent, if he was to make an offer at 4.9 percent, most likely he would have to come up with a 50 percent downpayment because that is one of the ways you get 4.9 percent.

Senator DASCHLE. Senator Boschwitz, perhaps if you have to go, perhaps I should express myself while you are here. I think it relates a little bit to what I said earlier to our last panel with regard to fact and perception. I applaud you. As Senator Boschwitz has said, I think anyone who takes imaginative and bold strokes certainly must brace himself for whatever criticism that comes with it.

There has been, in spite of your immense success, a good deal of criticism primarily from your borrowers. Not perhaps from your borrowers. I cannot speak from experience. But I can certainly say from the borrowers in my district because first the perception "buy North Dakota" or "buy Minnesota," has at least subtle implication that you are trying to find out-of-State investors who perhaps may be institutional in description or in background coming in to buy up the State. There is that implication there, and obviously that is not what is meant. But one could come to that conclusion by looking at the ad.

The second perception is that because you are offering this at 4.9 percent, my borrowers are currently paying 12.5 percent. So you are talking about a significant difference in availability and cost of capital. That too seems like a very sensitive and emotional point for a lot of my borrowers.

They are legitimate, I suppose, in asking why is it that anyone in the System can obtain land at 4.5 percent when I currently cannot even restructure my debt, and I am paying 12.5 percent. Now your reply to that might be, well, they have to pay 50 percent in a downpayment. Well, their reply would be doesn't that also lend itself to the institutional borrower. And are you not pitting the institutional borrowers against farmers who legitimately and historically have been on that land?

Now, I was interested in your comment that the vast majority of your new borrowers are farmers. That certainly is encouraging. While it may have been a very successful campaign, and I am not necessarily opposed to it at all, I can say from the wealth of experience that I have had in the last few weeks, having just been out there as has Senator Boschwitz, that there is a tremendous amount of either misunderstanding or outright opposition on the part of a lot of our borrowers to that practice, at least the advertising of the practice, as it is presented.

If you wish to respond to any of that, I would be happy to have your comments.

Mr. Buegler. You were right. We anticipated at the time we formulated these plans that there would be a lot of heat, but as I said earlier time was running out. We had to do something. It was evident that there was not any interest in farmland. The supply so far exceeded the demand that the selling price of real estate went down every time you sold a parcel of land. We had to renew the interest in real estate.

The only way we could jog people is with an advertisement that would peak their interest. That we did. In the written testimony I have submitted, in the first 6 weeks we received 20,000 inquiries. Last week when I got the numbers after 7 weeks, we have received 25,000 inquiries on 2,000 parcels of land.

Senator Daschle. If I could just interrupt?

Mr. Buegler. Yes.

Senator Daschle. How does an inquiry translate into the consummation of a sale? Of those 20,000, how many ultimately ended up in the sale of some property?

Mr. Buegler. We have 1,000 accepted offers.

Senator Daschle. Out of the 20,000?

Mr. Buegler. Over 1,000 accepted offers which I guess would translate into maybe 2,000 offers. I think that what we did with the ads was to create the heat that we thought. I spend a good deal of my time talking to our members to try to make them understand what it is that we have done. Through this interest, we have not sold, to my knowledge, one single parcel of land to an institutional investor.

Now I have not looked at every transaction, but to my knowledge, not one institutional investor. Ninety percent of the sales are to farmers who live within 5 miles of the land that we are selling who have now decided that it is time to buy, that perhaps land values have bottomed out; I better buy it now. Thirty percent of them are paying us cash on these transactions. We are also concerned about what it is that you are saying. I get many telephone calls about how can you sell land at 4.9 percent when I am paying 12 percent. Well, those borrowers would have to pay in most instances to get 4.9 percent 50 percent down, or pay 20 percent above appraised value to buy the land.

Senator Boschwitz. Is that an "or" or both? To get the 4.9 percent, do you——

Mr. Buegler. 4.9 percent you could get the land at appraised value with 50 percent down, or 20 percent above appraised value with a smaller down payment.

Senator Boschwitz. How much down in that case?

Mr. Buegler. I believe it is 10 to 15 percent which equates to a much higher rate of interest.

Senator Boschwitz. Yes. I did not want to interrupt.

Mr. **Buegler**. You were used to compensating balances.

Senator **Boschwitz**. That is correct. Your bank always requires that of me. And if I may say, then as you transfer this—much of this land, I might say, that you have in your inventory was surrendered back to you by the former borrower quite willingly, was it not?

Mr. **Buegler**. Yes. Not all of it was foreclosed on. A lot of people in the restructure of their obligations had decided to deed land back to us so that they could keep another parcel, that sort of thing.

Senator **Boschwitz**. Sure. I know of a number of people who have borrowed on one parcel, and they borrowed at this level, and the land value was down here, and they decided to give it back to you.

Mr. **Buegler**. Deed it back.

Senator **Boschwitz**. The money that you now receive for this land is also earning money, and as a result, is it fair to say that it is lowering the interest rates that your other customers have to pay?

Mr. **Buegler**. If we get to a point by March 31 where our current projections indicate that we will reach our objectives that we set for ourselves, and if we can stop the flight of borrowers from the district, it is our intention to lower interest rates for all of our borrowers because of the success of these two programs.

Senator **Daschle**. What is your cost of money right now?

Mr. **Buegler**. Average cost of money?

Senator **Daschle**. Average.

Mr. **Buegler**. Or our marginal costs?

Senator **Daschle**. Well, give me both.

Mr. **Buegler**. Our marginal cost is about $5.95, and the average cost is $9.70 as of the end of January.

Senator **Daschle**. So in either case to those skeptics out there how do you respond to the charge of subsidization to these borrowers? I mean obviously you are paying, you are buying down the rate of interest in order to provide this package.

Mr. **Buegler**. And we are borrowing money at higher rates than the buy-down on a lot of our restructures to keep the farmers on the land, and we have disclosed that completely to our directors and our membership. That is the price that we got to pay, and in the beginning when we got the directors together and told them what we were going to do, all 350 of them. We told them exactly what the consequences of this were going to be. That some people were going to be paying 8 to 9 percent to either buy property or to restructure their debts while they were continuing to pay 12.

But we asked them to stay with us for another 6 months to see if this program would work, and we would report back to them in March of 1987, and that is what we are going to do. And hopefully by that time, if these trends continue we will be able to accomplish exactly what we told them at that time, that if the program we will be able to lower our interest rates for you also.

Senator **Boschwitz**. May I say to my colleague from South Dakota that I do not believe the Omaha district is being quite as aggressive as the St. Paul district.

Senator DASCHLE. I would certainly associate myself with your remarks in that regard.

Senator BOSCHWITZ. I tell you you ought to listen to——

Senator DASCHLE. But I must say I am not sure that condones the buy-down in this case. Again, I emphasize here I certainly do not want to be critical. If this is going to work, perhaps we want to pursue it. But I do think we have a very serious concern in a period when frustration and outright deep-seated skepticism is running rampant out there. It is situations like this that need to be fully explained.

To say that we are going buy-down the interest rate for someone who can afford to put 50 percent down on some land but not buy-down the interest rate to that degree, in any case, to someone who needs a significant amount of forbearance deserves a lot of explaining. I am not sure that I am capable of doing that when I go to South Dakota.

I notice on this Farm Credit Council testimony in the back, there is a chart that gives the district, and it gives the number of forbearance actions, and it is not recorded for St. Paul. Do you happen to have the number of forbearance actions that have been provided in your district?

Mr. BUEGLER. We apparently have provided that information after this was submitted, and I do not have that information with me.

Senator DASCHLE. If you could, just respond in this regard. I do not even want a ballpark figure necessary, but I would be interested in what you view the buy-down in a normal forbearance action in your district at this point?

Mr. BUEGLER. I cannot give you the normal. Every single situation that we are faced with is different. Every one is different. In each transaction involving a restructure, we have given our loan officers a series of alternatives or options that they can sit down with a borrower and negotiate a bottom line. That can be cash out on a portion. It can be deed back. It can be write-down of principal. It can be a lower interest rate, any combination of all of the above.

For me to guess the average, I think would lead to maybe some conclusions that we would not want in the record.

Senator DASCHLE. Well, just for the record, and I would make sure that Senator Boschwitz is aware of this, in the category formally restructured loans, the St. Paul district ranks head and shoulders above the Omaha district. It is about four to one.

Senator BOSCHWITZ. Where are you looking?

Senator DASCHLE. I am looking at the report soon to be provided to us by Mr. Beesley. But it is not reported with regard to the forbearance actions. But I think this is the issue that we are going to have to address is that when we relate our willingness to be involved in forbearance to our willingness to be involved in some kind of an aggressive effort to commercialize the outstanding land and make it a profitable sale, there has got to be some kind of appreciation of the needs of both sides.

And certainly you have aggressively sought out and found buyers. We need to demonstrate that same kind of aggressivity when it comes to the forbearance, and you appear to be practicing what you preach if these figures are appropriate. I only wish that

Omaha and some of these other districts could demonstrate the same kind of aggressiveness.

But I will stop there because I know we want to hear from Mr. Beesley.

Senator **Boschwitz**. As you may have noted, Senator, in Mr. Buegler's testimony, he said he established a strike team for every nonaccrual loan they had. There were 8,100 of such nonaccrual loans, and 4 weeks later they had restructured 3,000 of them, 37 percent of them, which is not too bad. I must tell the chairman of the subcommittee how impressed I was with the length of the call. [Laughter.]

Then I will excuse myself.

Senator **Boren**. You are not telling with whom it was; are you?

Senator **Boschwitz**. I noted that you were talking to the President.

Senator **Boren**. I apologize. If I could just ask one question, and then I am going to turn it back to Senator Daschle to take over finish up. If I could direct a question to Mr. Beesley before I leave. I notice that the FCCA budget has a 37 percent increase in total administrative expenses including a 26 percent increase in salaries. I just wondered how we could justify that considering the situation we are facing out in the agricultural communities?

Mr. **Beesley**. Mr. Chairman, FCCA was organized in July of 1985 so it only had a half a year in 1985. It has had a full year's budget in 1986, and during the year 1986, FCCA was asked to handle the systemwide audit which cost several millions of dollars through Price-Waterhouse. Our operating budget is no greater than it has ever been, and in fact, the income that we generate for the System through national purchasing of insurance, data processing equipment, et cetera, more than covers the total budget of the FCCA.

Senator **Boren**. So what you are saying is you have not had an actual increase of these items except those that were associated with the audit and the other new responsibilities that you acquired after the formation; is that correct.

Mr. **Beesley**. That is correct. I do not know what period of time you are comparing.

Senator **Boren**. What timeframe that was.

Mr. **Beesley**. But 1985 was only a half a year.

Senator **Boren**. I see. What about in 1987 I notice your budget lists a 91 percent increase in purchase services?

Mr. **Beesley**. That would be the audit.

Senator **Boren**. That would be the audit. That brings the annual cost up to approximately $5 million. Will that now be a recurring cost in the future?

Mr. **Beesley**. That will be a recurring cost. It is one that has formally been handled through the Finance Subcommittee and the Funding Corporation in New York. That was simply transferred to our jurisdiction.

Senator **Boren**. I see.

Mr. **Beesley**. Several responsibilities handled by other systemwide committees have also been handed to FCCA.

Senator **Boren**. Right. One last question. We had requested information earlier this year about the number and amount of loans that have been restructured.

Mr. **Beesley**. That is correct.

Senator **Boren**. And the terms of the restructuring, in particular, we were interested in knowing the number of loans in which the principal had been reduced as a part of the restructuring, and I would appreciate your including part of this information in your testimony. You talk about the number of loans which have been restructured, but I wondered if it would be possible for you to break out of that 3,741 figure you mentioned the number that were restructured by having the principal written down?

Mr. **Beesley**. We can provide that for the record.[1]

Senator **Boren**. I would appreciate that being provided.

Again, I apologize for the circumstances that have developed; I know Senator Daschle also has pressing business, but he has agreed to stay for just a little while to take the remaining testimony for the record. I assure you it will get very very careful study from us and very serious consideration will be made of the comments you make. Senator Daschle, you want to come up here.

Mr. **Beesley**. Mr. Chairman, as you are leaving, let me just say that if there is a train leaving the station, the System will want to be on it.

Senator **Boren**. I am glad. We want to have a full load onboard as we leave. I appreciate that comment very much. Again, thank you, Senator Daschle, for stepping into the chair.

Senator **Daschle** [presiding]. Glad to do it. Mr. Buegler, before I lose my train of thought, you had mentioned that it is your anticipation that you would like to reduce the loan rates of all the borrowers if your venture is successful. Is it your anticipation that you will reduce the rates to 4.9 percent?

Mr. **Buegler**. No.

Senator **Daschle**. What do you tell your borrowers when you say that even in the best of circumstances, these guys are going to get 4.9, and you are going to pay more?

Mr. **Buegler**. First of all, the 4.9 percent only applies to land that we are selling. Approximately 13 percent of the land that we have sold has qualified for 4.9 percent interest rate financing. About half of that is recreational land that was put into farmland that is now going back into recreational land. That program, it is my intention to have it expire on March 31, 1987, and it should no longer be an issue after that date. You have to distinguish the difference between what we tried to do in acquired properties and stabilizing land values rather than driving down land prices.

A 5 percent drop in land values costs us about $200 million in provision for loan losses. The consequence of selling at this point in time a very small piece of our inventory at 4.9 percent was well worth the price of not having to suffer another $200 million devaluation in our portfolio. That is what I tell people. And after awhile on the telephone, and sometimes it takes up to an hour of explaining this because I refuse to write letters, sooner or later 9 out of 10 people understand what it is that we are trying to do. It is only on acquired property. It does not apply to restructuring. It is only for a short period of time to prove a point: that land values today are well below their economic value. We have to get the market value of real estate today back to its economic value so that we can survive in this business. And the only way we can do that is an interim period, a short period of time, creating a renewed interest in farmland, and I think we have done that. We have proved a point that land can be sold at greater than appraised value without giving away the entire portfolio at 4.9 percent. To date, as I said, that is only 13 percent that we have sold at that price.

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[1] See p. 112 for Mr. Beesley's response.

Senator DASCHLE. Thank you. I know that we can talk about this alone for whatever remaining moments we have in this hearing, and I won't belabor the point, but I would welcome Mr. Eberly and Mr. Beesley both, and commend you both for your patience and your tenacity and your willingness to wait as long as you have to be heard. At this time, Mr. Beesley, I will call on you for your statement.

Mr. BEESLEY. Thank you, Mr. Chairman. I appreciate the invitation to participate, and would ask that my testimony be entered into the record, and then I won't have to read it.[1]

Senator DASCHLE. Without objection and with enthusiasm.

STATEMENT OF H. BRENT BEESLEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT CORPORATION OF AMERICA

Mr. BEESLEY. There are approximately 100 pages of information here which I hope will be useful including considerable information about acquired property. Back in May 1986, the System adopted a policy for the management and disposition of acquired property which all System entities are trying to follow, including the St. Paul banks, which does outline the appropriateness for using interest rate as a means to maintain property values. Because if you sell it at below market values you create another round of problems, and it is a tradeoff.

I have just two or three short points I would like to make for the record. First of all, the System greatly appreciates the 1986 amendments. Without those amendments in place, we would not have the luxury of sitting down here today and discussing these issues with the Congress in this noncrisis atmosphere that we have today.

We are also grateful that it has allowed the System to set rates at competitive levels. Now rates have fallen substantially. In some areas, they have fallen less substantially than other areas. And we are working with those entities that are keeping their rates too high. It is the policy of the system that rates should be at competitive levels today. And where that is not occurring, we believe that the intent of Congress has not been met, and certainly the intent of our own internal policies has not been met.

Senator DASCHLE. What would you consider a competitive rate at this point?

Mr. BEESLEY. Well, it will vary from place to place, and it will vary from borrower to borrower. In my own case, I have a longstanding relationship with a bank. I just asked them for a loan the other day, and they said the rate would be 13 percent for 5 years.

Senator DASCHLE. Do you consider that competitive?

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[1] See p. 318 for the prepared statement of Mr. Beesley.

Mr. Beesley. Well, that was the rate they were quoting that day. I did not take the loan. I think that it varies. A lot of us are paying 18 percent on credit card loans. I cut out a clipping from the paper the other day—it is in my briefcase—on what the mortgage rates are in the Denver area for housing, and they are in the neighborhood of 9.5 percent. Housing loans are somewhat more easily made and easily serviced, and have less risk and are more marketable than most agricultural loans. But the policy that we have established clearly avoids any implication of a national rate. Rates should be set the local level based on local competitive conditions.

The only other point I would make, Mr. Chairman, is that we believe there is some optimism to be seen in the numbers of the Farm Credit System. If you analyze the losses that we have suffered in the last 2 years, it is pretty clear that those losses are driven by nonrecurring items, and there is no reason for us to assume that that loss pattern will continue into the future in the same level of magnitude as it has in the past. Nevertheless, we are having, as has been mentioned, considerable difficulty in fully implementing the 1985 and the 1986 amendments, and it may well be very necessary and appropriate to consider additional measures to protect the stock of our farmers.

Senator Daschle. Would you support certification right now?

Mr. Beesley. I do not know exactly what certification means. I think we would support the kinds of discussions that have been held here today. I think that cash may not be absolutely necessary, but it is absolutely necessary that we protect the members' stock.

Senator Daschle. Do you think cash is a possibility?

Mr. Beesley. I think if the Congress says it is a possibility, it is a possibility. We are not asking for cash.

Senator Daschle. No, but I am asking you, do you think as you consider all the options, as you sit down with Chairman Naylor at this point, and you consider the range of different options, have you discussed certification as we define it in terms of the need for, as you call it, cash?

Mr. Beesley. Yes, I have discussed it with all three board members. Let me say, however, the system has approximately $12 billion of cash today. Cash is not the issue. The issue is borrower stock and borrower confidence. We have more cash than we need. I wish we could find borrowers who need these loans and people to whom we can make good loans to. If you look at some of the charts that you see here, the total level of agricultural debt is declining rapidly in the United States. There is more cash around than there are opportunities to invest wisely.

Senator Daschle. Let me just say that I think one of my frustrations in the 8 years of having experience on the House Agriculture Committee was the lack of candor that occurred so often in the past with regard to true position and with regard to real need and the real situation. We are going through a time now when it is absolutely imperative that we be on exactly the same wavelength. I do not think this committee ought to even consider a response to certification with regard to additional Federal outlays if you genuinely do not believe that that is necessary.

How foolish would it be for us to pursue that course of action when in your best judgment and in the judgment of Chairman

Naylor and his two colleagues that it is not necessary. But whether or not we have that kind of understanding depends entirely on your ability to communicate the honest-to-goodness factual information as you see it, not a year ago, but as of today and in the future. If we have to go into a closed hearing to get that, I am sure this chairman would support something like that. But it is extremely important that we have that, I think. There is still not the confidence among some Members, and I am not speaking at all for the chairman since I have not had the opportunity to talk to him directly, about whether or not that environment exists today.

I would just hope that down the road as this train pulls out, as the chairman is fond of saying, that everyone understands just what the train looks like.

Mr. BEESLEY. I appreciate that. When you are dealing with financial institutions that have gone through the difficulty of the Farm Credit System, and we see ourselves being able to work our way out of this and turn around and come out again, that is the reason why the 1986 amendments make sense is because we see a turnaround as a possibility.

There are some factors that will impact that. If the borrowers do not have confidence in the System, it is irrelevant whether we think we can turn it around. It will not happen. So if the borrowers are losing confidence in the System and are insisting on paying off their loans because of their fear for their capital, as Senator Boschwitz mentioned, it may be very necessary and appropriate even at this time, while there is still uncertainty as to the final outcome, to take action which would appropriately alleviate those concerns.

It may also be that down the road, the System will need hard cash. That is not something that the evidence that I see makes conclusive either way at this point. Now, if people are uncomfortable with the uncertainty as to the ultimate outcome, the obvious answer is to provide some real cash. But then your losses were $2.7 billion last year. They were $1.9 billion this year. We are predicting them to be less than $1 billion next year, or in the neighborhood of $1 billion. Excuse me, in 1987. And we see this thing turning around, and we look at the losses that we sustained and we see that an enormous amount of that is because of our high-cost bonds.

There is a schedule in here that shows the run-off on those bonds, and it is occurring very rapidly. We see that our losses have been driven by loan loss provisions, and we hope that the bottom has been reached on these land values, and there is some evidence that maybe it has. Then we will not have to continue to build these loan losses.

But as I point out in the prepared statement, the farm program, the overall level of interest rates, the cost of production and the commodity prices received, all of these variables will impact the Farm Credit System's ability to collect the loans that have already been made.

So I am probably in a minority, and I am maybe somewhat of a minority within the System, but in terms of turnaround situations, this thing still has some very viable options other than pure cash.

If the borrowers or the investors lose confidence in the System, then some rapid action would be appropriate, and if that is a concern, and we do not want to have any more rapid actions, then I think it is very appropriate for Congress to consider some mechanisms that would safeguard the borrower's stock at this time.

Senator DASCHLE. Mr. Eberly.

STATEMENT OF SAM G. EBERLY, CHAIRMAN OF THE BOARD, FARM CREDIT SERVICES OF WICHITA

Mr. EBERLY. Thank you, Mr. Chairman. And I, too, appreciate your staying to spend these few moments with us. I would also like to have my prepared statement entered into the record, and I will try to paraphrase it briefly so that we might answer any questions you might have.[1]

I am the chairman of the Ninth District Board. I am also a member of the Board of Directors of both the Farm Credit Corporation of America and of the Farm Credit Council. All of the policies set by those three boards are all set by farmer-directors of the System.

The frustration, as we heard in a lot of the testimony this morning, is also shared by me. I feel frustration when I see a neighbor or a close friend losing his farm, and I also feel the frustration as a board member seeing the deterioration of our System and how rapidly that can occur, and know that really the only thing that will turn us around is a good solid farm income so that farmers can make a profit and repay their loans.

Most of you are familiar with the Wichita District. It comprises Kansas, Colorado, Oklahoma, and New Mexico. We serve around 60,000 members with a loan volume of approximately $4.4 billion.

The frustration that we have as a district board, or as board members sitting on a district board, is caused by the conflicting signals that seem to come to us. One is that the district must get tough and collect as much as possible from the farmers who are not making payments on their loans, and the other is that the district must restructure loans and leave troubled borrowers on the place.

We do want to restructure loans. Congress and the chairman of FCA are both urging us to do this. But a different signal comes from the examination supervision staff at FCA which is telling us in examination reports we must collect in full. That contradiction is one problem that we are encountering.

To set some records straight on operating expenses, in the last 14 months in our particular district, we have cut expenses by 24 percent. We have reduced staff at the district level by 20 percent. We made some of those hard decisions like reducing the Blue Cross/Blue Shield and thrift plan benefits to our staff of employees. That is hard to do, but it is a way that we can save some money.

In December, we sold our district headquarters office building. It allowed us to use that money to apply it against long-term debt, thus reducing costs. It is cheaper for us to lease that facility back on a short-term basis with an option to renew on a long-term basis. We are doing everything we can to reduce expenses, and I want you to understand that.

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[1] See p. 405 for the prepared statement of Mr. Eberly.

I feel quite strongly there is only one reason that we have a Farm Credit System, and that is that it benefits both the farmers and ranchers and the co-ops who are members of this System. What are these benefits? We have to make sure that the source is competitive, giving competitive rates, and it is efficient in its cost delivery system.

And I guess the question is, are we living up to these goals? I can tell you that in our district, the Ninth District, we are one of the few entities still lending money. Yes, they come and they go. But we are still there. Some insurance companies have pulled out completely. We have not. We are working with a new management team under the direction of Vern Peckham and staff, and no one is throwing in the towel in Wichita. We are here to stay.

We are trying to address some of the concerns that we have heard here this whole day. We have begun to work with our troubled loans. We started this SAG team effective December 1. And since that time they have worked very effectively with a large part of our troubled customers. We have to remember that these cases that they are working on are our worst cases.

A year ago, these total cases may have all been in foreclosure. But as we began to work with these, we see that as of February 19—and these are figures just for 2½ months—that this special assets group has worked with 738 loans, and in more than 300 of these cases, our specialists have restructured loans or found some way to keep the member on the land.

And in 675 cases, which is 90 percent of the total loans which the restructure group has taken over, we have settled with the customer out of court without having to go through that trauma. We have managed to avoid foreclosure. I think that is a good record at only 2½ months. We also believe that there are a lot of members that could be rescued now without incurring additional loan losses to our district by acting early in a lot of these individual cases. To accomplish this we will within the next 2 weeks, with the approval of an advisory committee which we received last week, begin to look at the next phase of debt restructuring with special emphasis on helping troubled borrowers or members before there is no hope for survival.

Our goal is to prevent the movement of loans and nonacquired property into the acquired status. And this district initiative is going to be in addition to the Capital Corporation Special Assets Group already in place.

At the same time I do not think we can lose sight of that member who is still making his loan payments current, and we have to provide some much needed interest rate reductions, too. We did that effective February 1. In part, as a result of the amendments, the interest rates to the majority of the stockholders in our district have decreased from 1 to 1¾ percentage points. And our best rate is now at 9.75 for our land bank and PCA members.

To sum up, I am here to tell you that the Farm Credit System is the farmers, the ranchers, and the cooperatives who really do the business with this cooperative. No more and no less. It is now time for us to demonstrate to these people that we can keep the System and it is worth saving, and we can demonstrate the support and the faith that they have had in us.

It was established by Congress, and we hope that the major purpose of the System has not changed, and that is to meet the need for credit when it was not available elsewhere. As I said in my beginning statement, I think profitability in agriculture is one of the only long-term solutions that we have toward solving the problems in the Farm Credit System. I thank you.

Senator DASCHLE. Thank you, Mr. Eberly.

I want to thank this panel for their excellent presentations and for the upbeat manner in which they presented the information. We are beginning to see signs of encouragement and new-found confidence. It would be a mistake, a serious mistake, to gloss over the problems that exist, and at the same time we do not want to dwell on it. We must find imaginative ways in which to deal with the situation as apparently you and St. Paul have both done. I commend you for your work and look forward to working—I know I speak for the whole committee in expressing our interest in working with you as we go through the next couple of months.

So with that, the hearing is adjourned.

[Whereupon, at 5:15 p.m., the subcommittee adjourned, to reconvene at 11:00 a.m., Thursday, March 26, 1987, in room 332, Russell Senate Office Building.]

[The following letters were subsequently received by the subcommittee:]

FARM CREDIT SERVICES,
Wichita, KS, March 11, 1987.

Hon. DAVID BOREN,
U.S. Senate,
Russell Senate Office Building, Washington, DC.

DEAR CHAIRMAN BOREN: I respectfully request that the attached letter be included in the official record of the February 26 hearing of the Subcommittee on Agricultural Credit.

The letter includes a response to a number of statements made during the hearing.

Thank you very much.

Sincerely,

SAM G. EBERLY,
Chairman of the Board.

Attachment.

FARM CREDIT SERVICES,
Wichita, KS, March 11, 1987.

Hon. DAVID BOREN,
U.S. Senate,
Russell Senate Office Building, Washington, DC.

DEAR SENATOR BOREN: Thank you for the opportunity to appear at the February 26 hearing of the Subcommittee on Agricultural Credit. During the hearing, a number of statements were made by other witnesses regarding the Wichita Farm Credit District. Below is a list of these statements, with our response. As I indicated to Kellye Eversole of your staff, we appreciate this opportunity to respond and clarify our district actions for the record.

1. "Despite enactment of a one year moratorium on foreclosures, the System continues to aggressively pursue these proceedings."

In recent months, we have been able to reach agreements with many borrowers out of court and avoid foreclosure. This is due to the Farm Credit System's own Special Assets Group (SAG) and debt restructuring actions, not the foreclosure moratorium enacted by the state legislature.

The one year moratorium was intended to stop FLB foreclosures but specifically allowed for foreclosure action by the Farm Credit System Capital Corporation, which as you know is active in our district. The moratorium was enacted in May of 1986, and was believed to be unconstitutional by many attorneys. Foreclosure actions continued to be filed, where necessary, in order to protect the interests of the majority of other farmer-stockholders. As these cases came to court, judges repeatedly found the moratorium unconstitutional. In fact, not one court in Oklahoma has upheld the moratorium.

More importantly, foreclosure is being avoided for many farm borrowers through the Farm Credit System's own debt restructuring policy and the Special Assets Group. One problem with a moratorium is that it does not provide true help to the distressed farmer who really needs it. The SAG has been able to negotiate many agreements on a case-by-case basis which are beneficial to both the lender and the farmer.

From December 1, 1986, (when they began operation) to February 19, 1987, the Special Assets Group has completed work on 738 cases. These are our most distressed cases and a year ago all 738 might have been in foreclosure. Of that number, more than 300 have been restructured or some alternative has been found to leave that farmer in operation. In 675 cases, or more than 90%, the SAG has been able to negotiate agreements with the borrower outside of court and avoid foreclosure.

We believe this type of policy addresses the concern which the Oklahoma legislature rightfully had, and does it in a way that is more workable than in an across-the-board, mandatory moratorium.

2. "Enid Land Bank officials have been quoted as saying they are preparing for a 'massive number of foreclosure actions'."

Rather then a "massive number of foreclosures" which some anticipated would be the result of the Special Assets Group, the SAG activities as described above have produced a number of agreements with borrowers outside of court. The situation in Enid remains a very difficult and sensitive one. Because of the very aggressive farm lending practices of the late 1970s, the Enid area has been hit particularly hard by the downturn in the farm economy. However, Enid Land Bank officials were strong and early advocates of a debt restructuring program.

3. "Farm Credit Services of Wichita has instructed member institutions to foreclose a 'minimum of 2 farms or ranches per county per month. . . .' "

Absolutely not. There is no requirement for any minimum number of foreclosures by any office; in fact, we are encouraging restructuring rather than foreclosure. We speculate that the basis of this comment is a memorandum from our legal department which was issued in connection with an assessment of whether or not the moratorium was constitutional. As part of that study, our association offices were asked to report to us on 2 foreclosure cases within their association territory. At no time has there been any directive or requirement on the number of foreclosures.

4. "The backlog of foreclosures and other cases has so clogged Oklahoma's District Courts that a 9- to 18-month foreclosure period of FCS is now the norm."

True. The court system is clogged, and a smart attorney can drag out legal proceedings for a long time if he or she chooses to use every trick in the book. Unfortunately, that benefits neither farmer nor lender. The costs and delay of legal proceedings is quite expensive for associations and their farmer-members.

5. "Farmers who have been current on their loan payments but whose collateral has been devalued are now facing loan acceleration."

It is not our policy to accelerate any loan without reason. Because of the drastic drop in land values since 1980–81, we have many loans which are less than fully secured and yet on which payments are current. That is a simple result of the drop in land values and is not in itself reason for acceleration. Of course, if risk is greater in these loans, they require closer monitoring and more active loan servicing. There may be misunderstandings where the borrower thinks he has brought the loan current but has not, or brings the loan current as of some previous notification received sometime ago. Even in those cases, however, if a borrower qualifies for forbearance we will defer, reschedule, or reamortize payment to help our farmer-members through difficult times.

The surest way for a farmer to keep his interest rates at the lowest possible level and avoid any legal problem is to make his payments fully and promptly.

6. (An example was cited of an individual who was behind on his payments and received a foreclosure notice; then the Federal Land Bank rejected his offer to bring the loan current and pay off the remaining loan as scheduled. In addition, the land was reportedly sold for much less than the original debt to a new purchaser.)

We would be happy to research this particular case if the name of the individual is provided with his or her permission so that we may make all the information available to you. In the meantime, be assured it is our preference that loans be brought current and legal action be avoided.

Possible causes of rejection of such an offer would include repeated problem repayment history, repeated promises to pay without performance, an offer to pay without the factual documentation, or a farming operation that is simply not viable in the long run.

As to the land resale, while we try to maximize returns on the sale of land values, all too often the land is sold for less than the amount which is owned on it. This too reflects deflation in land values of the last 6 years. Under our new debt restructing policy, we can and will make similar concessions to existing farm-owners as to potential new purchasers.

In handling land sales, we follow the following guidelines:

a. Our first preference is to get the land into the hands of a local farmer and rancher.

b. We try to move the property as quickly, as reasonably possible, so as to minimize costs to our associations and their farmer-members.

c. We will use financing tools as necessary to stimulate interest in owning farmland and to move properties without overly depressing land values.

Again, we would be happy to provide full information on the individual case described at the hearing if the individual's name can be supplied to us.

In general, our preference is to avoid foreclosure and legal action if possible. We are doing our best to adjust to these difficult times. We have intitiated more aggressive trouble debt restructuring programs and our Special Asset Group is implementing them.

These policies will be implemented on a *case-by-case* basis, because each individual case is different. Across the board, mandatory legislation can be unworkable and counter-productive, but case-by-case implementation of these policies as Congress has urged us to do can be of significant benefit to farmers and lenders alike. We appreciate the opportunity to clarify the record.

Sincerely,

SAM G. EBERLY,
Chairman of the Board.

[Written questions from Senator Boren and Mr. Naylor's answers thereto:]

SECURITIES

Question 1. Do you believe the Funding Corporation should be limited in its ability to secure funds for the System? Would it not be wise for the Funding Corporation to attempt to match securities if that means combining various methods of securing funds, such as packaging callable bonds with some noncallable bonds and perhaps some other debt instruments?

Answer. The Funding Corporation's role includes facilitating, advising, and managing a small central liquidity pool as agent for the System. Under the current law, the funding issues you raise are primarily the responsibility of the individual banks and of the System Finance Committee.

Each of the individual banks has the authority to issue securities, either in its own name or jointly with other banks in the Farm Credit System. The statute also provides for a finance committee composed of bank presidents or their designees to determine (subject to FCA approval) the amounts, maturities, rates of interest, and participation by the several banks in each issue.

The statute creates a fiscal agency that has been incorporated as the Funding Corporation, to handle "such of their functions relating to the issuance, marketing, and handling of their obligations, and interbank or intersystem flow of funds as may from time to time be required."

The authority to issue securities is rather broadly worded in the Act, but the scope has not been tested. Alternatives to funding via consolidated bonds and discount notes have been considered from time to time, but have been discarded because none offered as low a cost as current methods. Call provisions were included at one time, but the additional cost of bonds that are callable by FCS within 5 years or less has been viewed as prohibitive, while the gains from including long-term call protection are not very useful in today's volatile markets. The banks have increasingly used matched funding in their fixed rate lending programs, and are giving more attention, both individually and through Farm Credit Corporation of America, to asset-liability management to control risk. A major problem is determining the appropriate duration of FCS loans in order to appropriately match securities, since the range of market interest rates since 1979 has caused so much volatility in the amount of prepayment on loans. A similar prepayment problem occurred with securitized housing loans in 1986, causing investors to reassess the rates they asked to hold such securities.

The present discussions about securitizing farm loans rather than holding them in portfolio is another method of addressing some of these issues.

SYSTEM BUSINESS DECISIONS

Question 2. There have been some claims that the Farm Credit Corporation of America is unnecessary and duplicative of other institutions' functions. What is your opinion of this? Do you see a valid role in the System for the FCCA? What role does it currently play?

Answer. In my opinion, the issue of whether or not a nationwide network of agricultural credit cooperatives should have a primary administrative office that, among other things, is the group's primary spokesperson, is one to be determined by the group's membership, and not its regulator. Given the clear intent of the 1985 amendments that the FCA is an arm's-length regulator, not the System's representative in Washington, the System's members and leadership have been left with the charge to represent themselves.

Question 3. Please provides the Subcommittee with the salaries and the value of benefits of the Chief Executive Officers of all the System entities, the Farm Credit Corporation of America, the Farm Credit System Capital Corporation, the Presidents and CEOs of all District Banks and the President of the Farm Credit Leasing Corporation and the CEO of the Funding Corporation.

Answer. A chart is attached providing that information.

Question 4. Please provide the Subcommittee with the annual CEO costs for the 37 District Banks since 1980 when the cap was lifted off their salaries.

Answer. A chart is attached providing that information.

The current salaries for Farm Credit System district bank and Corporate entity CEOs are as follows:

Farm Credit Banks:

Springfield-	$132,500
Baltimore-	$185,000
Columbia-	$189,750
Louisville-	$146,000
Jackson-	$140,000
St. Louis-	$160,000
St. Paul-	$195,000
Omaha-	$180,000
Wichita-	$180,000
Texas FLB-	$115,000
FICB-	$105,000
BC-	$115,000
Sacramento-	$157,500
Spokane-	$130,000
Central Bank for Cooperatives	$178,000

Farm Credit System Corporate Entities:

Farm Credit Corporation- of America	$270,000
Capital Corporation-	$250,000
Funding Corporation-	$180,000
Leasing Corporation-	$178,000

Benefits:

FCA does not collect or maintain separate data on the value of benefits received by individual CEOs in Farm Credit System banks and Corporate entities. Throughout the Farm Credit System, however, CEOs are subject to the provisions of districtwide benefits programs, including pension plans, thrift or savings plans, leave, and health and life insurance programs. The other Corporate entities are affiliated with various Farm Credit district benefits programs.

The following data provides annual salary costs for the 37 Farm Credit bank presidents tabulated by district since 1980. Some of the consolidated district banks have been under the direction of a single CEO throughout this period, while others have had a unified management structure for only part of the period.

FARM CREDIT BANK CEO SALARIES- 1980 TO PRESENT
(In thousands of dollars per annum)

District	1980	1981	1982	1983	1984	1985	1986	(Current) 1987
Springfield	92.5	106	122.5	134.8	148.2	170	178.5	132.5
Baltimore	92.8	106.8	120	138	147.6	163.8	168	185
Columbia	190	210.7	236.6	272.1	296	189.8	189.8	189.8
Louisville	252.2	281.3	347.7	365	300	290	146	146
Jackson	227.3	249.8	260.4	286	308.3	340.9	140	140
St. Louis	246	263	290.5	310	150	162	160	160
St. Paul	204.7	233	230	256.3	161.2	180	180	195
Omaha	261.5	300	330	370	150	160	160	180
Wichita	213.5	237.5	262.5	304	300	146	146	180
Texas	210	234.4	265.7	299	140	140	144	333
Sacramento	189.3	208.8	232	247	273	180	150	157.5
Spokane	249.4	285.2	323.8	269	289	130	130	130
Central Bank for Coops	100	114	127.6	137.1	148	163	167.9	178
Total per annum	2529.2	2830.5	3149.3	3388.3	2811.3	2415.5	2060.2	2306.8

[Written questions from Senator Leahy and Mr. Naylor's answers thereto:]

RESTRUCTURING

Question 1. The Farm Credit System has suggested that it will be attempting to expand its efforts to restructure the debt of many of its farmer-borrowers. This will clearly have implications for the system's income and on its balance sheet.

What position does the Farm Credit Administration take on the use of debt restructuring by the System?

Does the FCA see any need for amended legislation or new regulations to enhance the use of debt restructuring?

Answer. The FCA encourages System institutions to make greater use of restructuring of loans when such action would be beneficial to the lender and the borrower. Not every loan can be restructured; what we would encourage the System to do is to consider restructuring as an appropriate component of sound business decisions.

I do not see the need for specific legislation mandating how and when restructuring should be considered by the lender. In my opinion, this would be over-regulation of normal business decisions, which could easily result in unnecessary and cumbersome paperwork.

LEGISLATIVE ASSISTANCE 1987

Question 2. The 1986 yearend financial results for the FCS indicate that the System has roughly $1.4 billion in remaining surplus. The System's external auditor has suggested that the future viability of the Farm Credit System is in doubt if current conditions continue.

Given these facts and the Farm Credit Administration's responsibility as a regulator how does the FCA go about determining whether the System has exhausted its internal resources to the point that it needs assistance?

If the FCA determined that this point has been reached what actions would it then undertake? For example, would the FCA recommend a particular amount and form of assistance to the Treasury?

If it would not, does the FCA know how the Treasury would go about determining how to best assist the Farm Credit System?

Answer. Based on the legal requirements for certification as provided by the Farm Credit Amendments Act of 1985, the FCA Board cannot certify at this time that the System is in need of outside financial assistance. The Farm Credit Act Amendments of 1986 further cloud the certification process. With the utilization of Regulatory Accounting Practices (RAP), the System technically might not exhaust its surplus capital until well into 1988 or beyond. As stated in my testimony, however, unless the System can resolve its litigation over sharing of surplus, Congress may need to take some action before certification is technically reached.

Until the FCA has completed more work on our financial model, we are unable to predict with any certainty when the System might need assistance or how much it might need. We anticipate having some of these answers by April.

We are aware of several legislative proposals being discussed that include some form of outside assistance, ranging from guarantees to direct capital infusion. It is my understanding that the Treasury Department is considering some of these options. I would expect Treasury to consider FCA's projections, as well as the pending General Accounting Office recommendations on assistance to the System, in developing some proposal that might include outside assistance.

LITIGATION

Question 3. The recent ruling in Massachusetts has left the System without guidance in terms of regulations for the funding of the Capital Corporation and for sharing capital. I know that you are appealing the decision but what interim action are you taking to provide the System guidance in this area?

Further, do you not think that it would be prudent to develop a set of regulations which conform to the court's ruling?

Answer. The Springfield decision is but one of a number of decisions which have been rendered by U.S. District Courts across the Nation on the regulations relating to assessments by the Farm Credit System Capital Corporation (Capital Corporation). A number of those decisions, including a decision by the District Court for the District of Columbia, have denied injunctions against the FCA and the Capital Corporation and have upheld both the constitutionality of the Farm Credit Amendments Act of 1985 (1985 Amendments) and the validity of the regulations and the procedures by which they are adopted. From a litigation viewpoint, the validity of the regulations and the related procedures will be determined by the appellate courts.

Pending those appeals, the Capital Corporation is continuing to function with the resources which it has, and individual System institutions can continue to rely on their voluntary loss sharing and capital preservation agreements, as well as regulatory accounting procedures authorized by the Farm Credit Act Amendments of 1986 and related FCA regulations.

In adopting the regulations as final regulations, the Board found that an emergency existed which required that the regulation be effective immediately upon adoption. The Board nevertheless ordered a period for public comment on the regulations, and subsequently extended the comment period several times at the request of System institutions. The Board adopted the regulations as final because it felt, based on numerous statements in hearings and the legislative history of the 1985 Amendments, that Congress wanted the Capital Corporation to be fully operational as soon as possible. The procedures which it elected to follow in adopting the regulations have been utilized on numerous occasions by other Federal financial regulators, including the Federal Home Loan Bank Board. The Springfield court disagreed with the Board's finding as to an emergency. However, as noted above, a number of courts have upheld the procedures by which the Board adopted the regulations.

The FCA Board has always recognized that adjustments to the regulations might be necessary. It is for that reason that the Board solicited comments when it adopted and published the regulations as final. However, before it received comments from System institutions and other interested parties and had the opportunity to respond, the FCA became involved in costly and time consuming litigation instituted by System institutions against the FCA and the Capital Corporation.

The FCA has been conferring with the Department of Justice in connection with an appeal of the Springfield decision. The FCA staff has begun some time ago to formulate recommendations for adjustments to the regulations in response to both the public comments which were received and further staff study of the related issues. The formulation of those recommendations, as well as the procedures for making any adjustments to the regulations, are continuing and will take into account an analysis of the various District Courts decisions which have upheld or invalidated the regulations, including the Springfield decision.

[Written question from Senator Boren and Mr. Duncan's answer thereto:]

Question. From an economic standpoint, what would be the implications of eliminating joint and several liability? In particular, what effect would this have on local associations?

Answer. Joint and several liability could likely be eliminated without any significant problems for the FCS institutions if it were replaced with a reserve fund to ensure investor confidence in the systems bonds and discount notes.

Given the proliferation of System lawsuits over implementing System resource sharing, investors might have greater confidence in a well devised reserve fund. The degree of confidence by investors is reflected in the interest rates charged on FCS bonds and discount notes. Greater confidence means lower interest rates on FCS obligations. A reserve fund would greatly reduce—if not eliminate—the need for districts to share their retained surplus with each other, this enabling a district bank to retain its surplus for the benefit of its own borrower stockholders. It is likely that a small fee would be paid into the reserve fund by FCS banks in order to participate in systemwide debt sales. As a result, FCS institutions might prefer the fee system under a reserve plan to the more open-ended obligations they now face under capital preservation and tiered liability, as well as the claims on part of their surplus under the 1985 Farm Credit amendments.

To illustrate the impact on association interest rates, consider the PCA for example. In the case of the PCA, the interest rate charged it by the FICB is composed of the average cost of the FICB's bonds and notes outstanding, plus an added spread to cover FICB operating costs, provisions for loan losses, and allocations to retained earnings. Replacing joint and several liability with a reserve fund into which a fee was paid would result in an increase in FICB costs by the amount of the fee. Improvement in investor confidence, however, could result in a reduction in interest costs. PCAs then add their own spread, reflecting their costs, to the FICB rate to determine the interest rate charged the borrower.

[Writter questions from Senator Boren and Mr. Billington's answers thereto:]

Question 1. In your opinion, what should the purpose of the Farm Credit System be and is that consistent with its original purpose?

Answer. The Farm Credit System's purpose is to be a farmer-owned and directed cooperative that provides a dependable and affordable source of short, intermediate, and long-term credit to farmers and ranchers and their cooperatives. It should enhance and improve the income and well-being of families who farm in America by furnishing sound, adequate, and constructive credit to them, their cooperatives and to selected farm-related businesses necessary for efficient farm operations. It should also be the objective of the System to include farmer and rancher/borrower participation in the management, control, policy making and ownership of a cooperative system of credit and agriculture that will be responsive to the credit needs of all types of agricultural producers.

Question 2. Do you believe the capital assessment regulations should be re-written, particularly in light of the recent Springfield decision? If so, would you explain your reasons.

Answer. I believe that the Capital Assessment Regulations should be re-written. PCAs, FLBs, and BCs cannot operate successfully in depressed times with depleted capital. I believe that in normal times, assessment regulations can be written which will be fair and just to not only the entities that are suffering losses, but also to the entities which still operate on a safe and sound basis due to sound financial planning and management practices. These are abnormal times and the System has now shared all the capital that it can with few exceptions and continue to compete. On March 31, 1987 there will only be approximately $1 billion in unallocated reserves remaining, an amount that will be difficult to assess, considering today's high interest rates and operating costs.

Question 3. Do you believe Congress intended for the assessment regulations to ensure the continued viability of local, relatively healthy associations?

Answer. I believe that Congress intended for the assessment regulations to reduce the capital in banks and associations only to the point that their continued viability would be un-compromised. All PCAs and FLBs are experiencing credit problems which take more staff time, expenses, and reserve requirements, all causing pressure to increase interest rates which escalates the total problem.

Question 4. Given the cooperative nature of the System, do you believe that differential interest rates are necessary and/or proper?

Answer. One of the primary reasons for the huge amount of borrower-flight in the System is the fear of stock impairment, use of differential interest rates, and lack of confidence in the System. Due to my past experience as a cooperative lender, I know that a majority of farmers expect all borrowers to be treated alike. Borrowers facing financial difficulties are doomed to foreclosure if rates they pay are materially increased compared to rates of sound borrowers. Differential rates at the association level only lead to member-borrower dissatisfaction, mis-trust, and borrower flight. Differential Rates have been used successfully and are appropriately used by the Bank for Cooperatives and the Central Bank for Cooperatives.

Question 5. In 1971, Congress expanded the authority of the System institutions with respect to the types of loans and the purposes for those loans and in particular, Congress allowed the System to become more diversified in its loan portfolios. Do you believe that has been successful and that it has aided the System? Further, do you believe the Farm Credit system should diversify its loan portfolio further and broadly begin making agricultural loans?

Answer. The Congress has already set up three types of banks in the district Farm Credit System:

The Banks for Cooperatives and the Central Bank for Cooperatives provide credit to a broad-based farm cooperative system in this country. Their loans are varied, but require a certain level of employee competence and specificity.

The Federal Intermediate Credit Banks loan money on an annual basis to PCAs and OFIs, usually taking crops, livestock, machinery and equipment as collateral. They are also empowered to make intermediate term loans to those borrowers who wish this type of credit. This again is a very specialized type of lending and requires highly trained and skilled loan officers.

The Federal Land Bank System is designed to furnish long-term amortized loans secured by first mortgages on real estate. This System had a long record of success until the 1971 Act was fully implemented. The moment land prices nose-dived, the permissiveness allowed in the 1971 Act doomed this long-term lender inoperable due to its ability to loan such a high percent of the market value of the farm properties.

This had led to huge financial losses that are dragging the other parts of the System down.

It is my sincere opinion that allowing the district boards and the FCA to set policies for the associations and to become involved in their management was a serious and costly mistake. Also allowing the FCA to delegate its examination and supervision authority to the district banks created a management scenario that was doomed to failure. The 1985 Act corrected this last weakness by making the FCA an arm's-length regulator. This cooperative System is vital to all farmers and to all of agribusiness because it sets the benchmark by which all agricultural loans are made and administered in rural America. It is my recommendation that the System maintain strong associations that are cooperative in nature, and locally managed and controlled. The role of the banks could be more clearly set out and should be that they efficiently and effectively disintermediate funds from the agency market to the associations. They should continue to have a role in management and training of association employees and directors. They should continue their role in providing joint services that are more efficiently done on a regional or national level. Once this System is returned to the hands of the stockholders, directors and management teams and once it is appropriately regulated by the FCA, then I am sure that this System will return to its former status and importance in American agriculture.

Farm Credit Corporation
of America

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March 21, 1987

Senator David L. Boren
Chairman, Subcommittee on Agricultural Credit
United States Senate
Russell Building
Washington, D.C. 20510

Dear Chairman Boren:

Enclosed are responses to your written questions dated March 16, 1987. These questions and responses pertain to the hearing held by the Subcommittee on Agricultural Credit held on February 26, 1987. Please let me know if additional information or clarification would be helpful.

The Farm Credit System appreciates your interest and concern in the System and its members, and we look forward to working with you.

Sincerely,

Brent Beesley

H. Brent Beesley
President and
Chief Executive Officer

HBB/rt

Enclosures

(Sent Airborne)

Question 1. In the budget of the FCCA, there is a 5.2 percent increase in merit increases. Is this increase being provided to support personnel or to top-level management?

Response. Merit increases are being granted to both top-level management and support personnel. Increases are granted according to a merit matrix schedule which considers job performance and position in salary range.

1987 merit increases to top-level managers average 2.9 percent and increases to support personnel average 6.1 percent.

President and Chief Executive Officer H. Brent Beesley has voluntarily frozen his salary since he first became employed at FCCA. He has received no increases of any kind.

Question 2. As I understand it, 22 percent of the staff salary and the corporate employee relations budget represents employee benefits. Would you provide the subcommittee with a detailed listing of these benefits and divide up the listing between benefits for support staff and top-level management?

Response. FCCA employees participate in the benefits plan of the 12th Farm Credit District (Spokane). Employer-paid employee benefits which cost the employer approximately 22 percent of the amount paid in salaries are comprised of the following:

- Retirement Plan
- Insurance (including Medical, Dental, Disability, Life, Travel, Workers Compensation)
- Employer Taxes (Federal, State, Local, Employee Taxes)
- Thrift Plan Savings
- Employee Relations Programs

Taxes comprise over one-fourth of the total cost (8.8 percent). The balance of the benefits (13.4 percent) is detailed on Exhibit A which also shows the division of benefits between support staff and top-level management.

Question 2.

EXHIBIT A

Benefit	Support Staff Amount	Percent of Salaries	Top-Level Management Amount	Percent of Salaries	Total Amount	Percent of Total Salaries
Retirement Plan	$223,872	7.5	$88,924	7.5	$312,796	7.5
Insurance (including medical, disability, life, travel, workers comp.)	147,991	5.0	35,059	3.0	183,050	4.4
Thrift Plan Saving	21,785	.7	31,520	2.7	53,305	1.3
Employee Relations Programs	7,120	.2	880	N/A	8,000	.2
Total	$400,768	13.4	$156,383	13.2	$557,151	13.4

Question 3. The FCCA budget allocates $533,913 for "System Work Groups/Task Forces." Would you provide the subcommittee with a listing of each of these groups, the dollars allocated per group, and the purpose of the group?

Response. The 1987 budget provides for System Work Groups/Task Forces as follows:

Listing of Work Groups/Task Forces

- Loan Officer Information Work Group
- Credit Accreditation Work Group
- Review Accreditation Work Group
- Appraisal Accreditation Work Group
- Key Industry Studies Work Group
- Special Review Work Groups
- Management Information Work Groups and Task Forces
- Accounting Standards Work Group
- Communications Work Group
- Credit and Operations Work Groups
- Human Resource Information System Work Group

Please see Exhibit B for the dollars allocated and purpose of each group.

Question 3.

EXHIBIT B

Work Groups/Task Forces	Dollars Allocated	Purpose
Loan Officer Information Work Group	$ 11,878	Develop an automated credit data base system which will enhance loan officer efficiency, coordinate credit review requirements and provide a single reporting system for credit and asset management reporting requirements.
Credit Accreditation Work Group	9,502	Design a national comprehensive credit accreditation program including principles, curriculum, training guidelines and testing.
Review Accreditation Work Group	4,751	Design a national comprehensive credit review accreditation program including principles, curriculum, training guidelines and testing.
Appraisal Accreditation Work Group	4,751	Design a national comprehensive credit appraisal accreditation program, including principles, curriculum, training guidelines and testing.
Key Industry Studies Work Group	7,127	Study and analyze selected key industries that may have an influence on System lending practices.
Special Review Work Groups	78,180	Use System employees to conduct at least four district credit reviews to evaluate the quality of district review and audit programs.

E050/NB3
3/24/87

Management Information Work Groups and Task Forces	247,877	Use System employees for the research, development, selection and implementation of Systemwide business technology standards (hardware, software and associated services). Bring the System to a common automated processing environment and be involved in negotiating national contracts which will provide substantial discounts.
Accounting Standards Work Group	31,774	Study, evaluate and coordinate System accounting standards.
Communications Work Group	14,820	Advisory group for national advertising and public relations programs.
Credit and Operations Work Groups	114,608	Use System employees and other resources to research and analyze credit and operational issues assigned by the Credit and Operations Committee such as: System exposure to cross-border risk, assignment of commodity certificates to lenders; tax implications of below market interest rates; FCA consolidated reporting; development of the model competitor analysis program; selected secondary mortgage market issues.
Human Resource Information System Work Group	8,645	Select a standard System human resources management information processing system.
Total	$533,913	

E050/NB4
3/24/87

Question 4. I notice that the FCCA budget mentions a "System employee handbook." I would appreciate your providing the subcommittee a copy of this handbook.

Response. The System "employee handbook" has not been printed. Although money was budgeted to print such a handbook in 1987, the districts are presently considering a consolidated Systemwide employee benefits proposal. Because benefit coverages would be an integral part of the handbook, publication has been deferred.

Question 5. Please provide the subcommittee with the number of long-term loans (15 years or longer), by district, that have been made in the past two years and which contain a fixed rate of interest for the duration of the loan.

Response. The Baltimore and Columbia districts are the only districts reporting fixed rate loans of a 15-year or greater term. During the last two years, Baltimore made a total of 835 loans and Columbia made 784 loans with the interest rate fixed for 15 years or longer. The Omaha District reports they have 11 acquired properties financed under sales contracts with a rate fixed for 15 years or greater.

E050/NB5
3/24/87

Question 6. Your testimony before the subcommittee indicated that the System is carrying a large amount of cash. Can you explain why this cash is not invested in farm loans, since it would appear that they would yield a much higher rate of return for the System? In addition, please provide the subcommittee with exactly where this surplus cash actually is, by district, and in what form it is.

Response. As of December 31, 1986, $11.4 billion was held in cash and investment securities by all System institutions. Cash and investment securities held by districts and banks are shown in Exhibit C.

There are two basic reasons that the level of cash and investment securities was $11.4 billion at year-end 1986 and that such amount was not invested in farm loans:

- Farmer loan demand has declined significantly since 1982, with an especially significant contraction of those credit needs during 1985 and 1986. Accordingly, the Farm Credit System is experiencing a run-off of loans and there is no unmet farmer loan demand.
- There is a need within the Farm Credit System to maintain an amount of cash and investment securities for liquidity purposes.

Both of these reasons are expanded upon below.

Reduced Farmer Loan Demand

Overall agricultural credit needs, as represented by the USDA's data of Total Farm Debt Outstanding, have been declining since 1982 with a more significant decline in 1986.

More specifically, borrower/owners of the Farm Credit System have reduced their borrowings from $81.9 billion at the end of 1983 to $58.2 billion at December 31, 1986. This reduction of $23.7 billion in loans outstanding evidences:

- the reduced demand for agricultural credit as evidenced by the USDA data previously cited;
- the prepayment of loans by better quality borrower/owners who are concerned that their stock in the Farm Credit Bank from which they received their loan may lose its value and may not be repaid at its full par value when their loan would normally mature;
- the prepayment of Farm Credit System loans by better quality borrower/owners who are moving their loans to competitors of the Farm Credit System because the rates of interest charged on their loans are not as low as those of the System's competitors; and

- the prepayment of Farm Credit System loans which were initially granted to borrower/owners for the purpose of profiting from arbitrage activities. For example, many farmers borrowed at 12 percent from the System and invested the funds at 16 percent. Loans are now priced so that these arbitrage opportunities do not exist.

Need for System Liquidity

The Farm Credit System is dependent upon its ability to issue debt in the public capital markets in order to fund its operations as well as to meet its maturing debt obligations. In spite of the adverse publicity and financial distress experienced by the System in 1985 and 1986, the System has continued to obtain adequate funds at reasonable interest rates to meet its needs. However, as the System's financial difficulties and the adverse publicity surrounding such distress have increased, the management of the Farm Credit Banks have implemented programs which significantly increased liquidity. This is to provide funds to meet maturing debt obligations, daily operating costs or loan demand in the event the System is unable to access the financial markets in the normal course of business.

As a result, cash and investment securities of $11.4 billion at year-end 1986 provide adequate (but not excessive) liquidity for the System. This conclusion is supportable by the following ratios:

Cash and investment securities as a percentage of:	
Total liabilities	17.7%
Systemwide and Bank debt maturing in 1987	33.9%

In achieving the System's liquidity objectives, it should be noted that over 99 percent of the investment securities mature in less than one year. Moreover, cash and investment securities at year-end 1986 consisted of the following:

	Millions
Cash	$ 436
Federal funds	5,726
U.S. Treasury securities, at par	286
U.S. agency securities, at par	154
Systemwide funding reserve*	1,743
Bankers acceptances, certificates of deposit and other securities, at par	3,090
Unamortized premium or discount, net	(22)
	$11,413

*Federal funds and short-term money market instruments.

To the extent there is perceived to be any "excess" liquidity, it should be noted that the yield of investment securities held at December 31, 1986, was 7.88 percent vis-a-vis a comparable weighted-average borrowing cost for consolidated Systemwide notes of 6.14 percent. Accordingly, any "excess" liquidity contributes to the profitability and the capital adequacy of the System.

Please see Exhibit C for the details as to which districts and which banks within those districts held cash and investment securities at December 31, 1986.

Question 7. What is the interest rate on nonaccrual loans by District? Is it the policy of System institutions to increase the interest rates on loans that are past due and on nonaccrual loans? If so, please explain your justification for this practice. Is it not the policy of most System institutions to increase interest rates on borrowers as their financial condition worsens?

Response. Current interest rate policies within the FCS do not call for automatic interest rate increases on past due and/or nonaccrual loans. The System, in accordance with prudent business practice, does charge late payment fees for delinquent loan installments. The late payment fee is charged only on the delinquent installment and ranges from 0 to 4 percent. The interest rate on principal or payments not yet due does not change.

Recently, many entities within the System have added multi-tier interest programs. A multi-tier interest program takes into consideration credit risk and loan servicing costs; not whether the loan is past due or nonaccrual. The less credit risk, the lower the interest rate. Multi-tier interest programs, which are considered prudent business practice by all commercial lenders, have enabled the FCS to lower interest rates to its financially stronger customers. A nonaccrual loan contains greater risk and thus would pay a higher interest rate than a low risk loan. This principle is followed in most business enterprises including cooperatives. For example, poor quality wheat gets a lower price at the co-op; better quality wheat gets a higher price.

Question 8. I would appreciate your providing the subcommittee the losses, over the past five years, by size of loan and gross agricultural sales affiliated with the loans that have occurred within the System. Additionally, please provide the subcommittee with the size of each loan in the nonaccrual and high risk category, based on year-end 1986 figures.

Response. The System has never tracked losses by size of loan and gross agricultural sales class. The following table (Exhibit D) shows loan losses and losses on sales of acquired property for each Farm Credit district for 1986. The table also shows loan losses and acquired property losses for the combined Farm Credit System for the last several years.

As of year-end 1986, the System had 44,037 high-risk loans with an average loan amount of $118,075; and 50,569 nonaccrual loans with an average loan amount of $129,294.

Question 8.

EXHIBIT D

Loan Charge Offs and Losses on Acquired Property During 1986

District	Loans Charged Off	Losses/(Gains) on Disposal of Acquired Property
	- - - - - (Millions of Dollars) - - - - -	
Springfield	$ 1.9	$ 0.3
Baltimore	1.8	0.4
Columbia	71.7	15.7
Louisville	166.2	0.3
Jackson	116.3	23.6
St. Louis	92.1	(0.7)
St. Paul	309.5	(7.0)
Omaha	290.2	(1.4)
Wichita	200.3	(3.3)
Texas	16.1	1.3
Sacramento	85.4	41.2
Spokane	34.8	(1.4)
System Total, 1986	$1,386.3	$ 71.8
System Total, 1985	1,239.8	260.0
System Total, 1984	447.9	20.0

E050/NB10
3/24/87

Question 9. There are rumors that there are some reasonably fantastic retirement benefits in the System and that there are approximately $125 million over-funded retirement programs in the district banks. How does the System intend to use these funds? Will they be used to reduce interest rates to borrowers or rather used to enhance salaries and/or benefits for System employees?

Response. Average monthly pension payment amounts at three different salary levels for Farm Credit System retirement plans are shown in Exhibit E. When compared to a sample of large commercial banking organizations, System pension benefits are moderately higher. A comparison to Civil Service Retirement is also shown. You will note that Civil Service Retirement exceeds the retirement benefits of the System.

Farm Credit System pension plans are well funded and the market value of plan assets exceeds the accrued benefit obligation. Under the Employee Retirement Income Security Act of 1984 (ERISA), the only way plan assets may be reverted to System entities is by plan termination, an expensive and time consuming process. To date, three Farm Credit districts have terminated their plans or have begun the termination process. These districts expect to recover a total of $95 million in excess assets. In many cases, any excess funds are being used to strengthen the banks' capital position and reduce costs. All but three districts have suspended contributions to their pension plans, which they are able to do because the plans are well funded. Two other districts have substantially reduced pension contributions for the same reason. Thus, the funded status of the plans has enabled the System to substantially reduce pension expense and thereby directly reduce bank operating costs.

Question 9.

EXHIBIT E

1986 Monthly Pension Amounts at Three Pay Levels

	Final Average Salary of $15,000	 $25,000	 $50,000
Farm Credit Average	$499	$ 912	$2,046
Large Commercial Banks	465	831	1,883
Civil Service	703	1,172	2,344

Question 10. What decision-making is actually done at the local level? I recognize that it is very little, but if I were a potential borrower, walked into my local land bank office for a loan, and you were on the local board, exactly what decision-making authority would you have?

Response. District Banks delegate loan making authority to Federal Land Bank Associations and Production Credit Associations. Delegations to Associations range from $0 to $5,000,000 (Please see Exhibit F). These delegations vary depending upon the demonstrated credit performance and financial condition of the particular FLBA or PCA. The FLBA or PCA will delegate authority to individual loan officers based on the credit competency level of the loan officer.

Individual Federal Land Bank offices would have various levels of loan authority based on the delegations to the individual FLBA they are a part of and the competency level of the loan officers headquartered in that office.

Question 10.

EXHIBIT F

Dollar Ranges of Credit Authority Delegated to Associations By Farm Credit Districts

	PCAs		FLBAs	
District	From	To	From	To
Springfield	$ 200,000	$1,000,000	$ 200,000	$1,000,000
Baltimore	74,000	1,400,000	100,000	500,000
Columbia	200,000	1,000,000	200,000	1,000,000
Louisville	300,000	1,000,000	100,000	1,000,000
Jackson	250,000	500,000	250,000	500,000
St. Louis	500,000	2,000,000	500,000	2,000,000
St. Paul	750,000	2,000,000	750,000	1,500,000
Omaha	300,000	500,000	300,000	500,000
Wichita	100,000	750,000	100,000	500,000
Texas	0	4,500,000	100,000	1,000,000
Sacramento	750,000	3,000,000	1,000,000	2,000,000
Spokane[1]	5,000,000	5,000,000	5,000,000	5,000,000

[1] Delegation to districtwide association

Note: Districts use other criteria in addition to loan size to determine delegations. Examples of such items are district credit risk indexes, financial ratios, etc.

E050/NB14
3/24/87

Question 11. There seems to be a considerable amount of interest in maintaining as much local control as possible. Where do you believe the final decision on a land bank loan ought to be made -- at the local level where the Board members know the potential borrower or at the district level?

Response. It is important that credit decisions be made by well-trained, competent loan officers. Decisions should be made at the level in the organization nearest the borrower, consistent with the proven abilities of loan officers. Ideally, all credit decisions would be made at the local office; however, the size and complexity of the loan may exceed the training and experience level of local loan officers. In such cases, it is necessary to have the loan action be at another level in the organization, by loan officers with the proper level of expertise. Also, some lending decisions involve loans of such large size that the decision can have extreme financial impact on an entire district. Prudent risk management procedures dictate that the local loan officer's recommendations on these large loans be reviewed and ratified at the regional or district level.

It is the responsibility of boards of directors at all levels to employ competent loan officers and delegate authority to these employees based on their level of competence.

Question 12. Please provide the committee with the number, by district, of loans that have been made over the past five years to people who are not engaged in the production of agricultural commodities and who are not going to use the loan proceeds for agricultural purposes.

Response. Services provided by the FLBs and PCAs are available to persons who are stockholders or members and are (1) bonafide farmers, ranchers, producers or harvesters of aquatic products, (2) persons furnishing to farmers and ranchers certain farm-related services directly related to their on-farm operating needs, or (3) owners of rural homes. Also, credit factors must be acceptable.

We know of no loans made to ineligible persons. Any such violations would most likely be noted in FCA examination reports. This is not to say that such loans have not been made. However, such loans are the exception and are in direct violation of our policies.

Question 13. What are the exact requirements a person must meet before being eligible for a federal land bank loan? For example, in the past, loans could only be made to agricultural producers. Is that still the case? If so, what is the definition of an agricultural producer?

Response. To be eligible to borrow from an FLBA, an individual's qualification as a bonafide farmer, rancher, producer or harvester of aquatic products shall be established as a part of the application for credit.

The definition of a farmer, rancher, and producer or harvester of aquatic products is:

- A bonafide farmer or rancher is a person owning agricultural land, or engaged in the production of agricultural products, including aquatic products under controlled conditions.
- A producer or harvester of aquatic products is a person engaged in producing or harvesting aquatic products for economic gain in open waters under uncontrolled conditions.

Question 14. It appears from the information you provided the subcommittee that the average loan amount on restructured loans is approximately $200,000. Does this correspond to the average loan amount the System makes or is it much larger than the average?

Response. The average size loan in the Farm Credit System is approximately $78,000. The average size of the nonperforming loan is $131,000. Loans with the potential for restructuring come from the nonperforming category. The average loan restructured has averaged approximately $196,000 and is greater in size than the average loan or the average nonperforming loan.

E050/NB16
3/24/87

Question 15. I would appreciate your providing the subcommittee with the number and volume of loans, by sales class, by district that have been made over the past five years. In addition, I would appreciate having the average term of these loans, not the term over which they are amortized, but the actual term of the loans.

Response. The number and volume of Federal Land Bank loans made for the years 1982-1986 are provided in Exhibit G. The data by sales class were not available for this response.

The average life of the Federal Land Bank loans paid off in 1986 is presented below.

Average Loan Life of FLB Loans
Paid Off During 1986

District	Average Loan Life
Springfield	9.4 years
Baltimore	6.1 years, Ag Loans
	7.2 years, Rural Home Loans
Columbia	Not Available
Louisville	5 years
Jackson	8.8 years
St. Louis	Not Available
St. Paul	6.8 years
Omaha	9.6 years
Wichita	3 to 10 years
Texas	3.9 years
Sacramento	8.9 years
Spokane	9.6 years

E050/NB17
3/24/87

Question 15.

EXHIBIT G

Number and Volume of FLB Loans Made: 1982-1986

Year

	1982		1983		1984		1985		1986	
District	No.	Vol.	No.	Vol.	No.	Vol.	No.	Vol.	No.	Vol.
Springfield	1,819	$132,264,071	919	$ 70,164,189	689	$ 47,488,956	547	$ 39,545,524	344	$ 37,323,008
Baltimore	3,834	277,724,335	2,988	226,771,891	2,933	228,193,021	1,873	149,423,415	1,970	190,302,705
Columbia	8,868	654,787,762	5,666	400,740,730	4,495	319,273,521	3,218	219,817,019	1,888	139,508,013
Louisville	5,196	554,100,000	3,602	319,100,000	3,675	339,300,000	1,935	157,800,000	971	72,700,000
Jackson	3,278	435,866,000	1,655	226,232,000	1,735	201,378,000	978	116,053,000	223	22,652,000
St. Louis	5,389	634,000,000	3,781	362,000,000	3,513	330,000,000	N/A	N/A	N/A	N/A
St. Paul	11,357	1,281,103,000	8,959	941,854,000	7,454	731,032,000	3,385	309,487,000	1,013	94,221,000
Omaha	7,006	794,729,400	5,132	472,594,600	4,205	408,730,700	1,460	112,392,700	360	27,458,000
Wichita	6,567	732,933,620	3,397	339,769,700	3,372	326,622,265	1,836	158,309,410	898	79,073,319
Texas	3,517	362,127,200	2,400	265,267,000	3,009	358,085,300	2,476	287,805,800	976	120,788,600
Sacramento	2,518	820,508,150	1,884	620,051,675	1,780	579,292,065	1,169	323,106,036	903	319,187,807
Spokane	3,266	479,165,000	2,234	321,657,000	2,017	282,459,000	1,162	154,130,000	519	80,203,000

E050/NBA2
3/20/87

Questions 16 & 17. Do you believe Federal Land Bank interest rates are competitive with other lenders?

When you say competitive, are you adding in the additional 3/4 to 1 percent increase resulting from the requirement to purchase stock?

Response. Pricing varies by region. Consequently, the degree to which the respective FLBs are charging competitive rates will vary. All districts have focused efforts over the last several months on introducing competitive loan products and additional drops in interest rates are being planned by some of the districts. All districts have lowered interest rates.

Currently, five districts believe their FLB loan rates are competitive, six believe their rates are not competitive. One district is competitive for some products and not for others. This evaluation takes into consideration stock requirements.

Those districts which have not lowered interest rates enough to be competitive are constrained by their heavy loan and operating losses and the need to operate in a safe and sound manner, as determined by the regulator. Despite the passage of the 1986 Amendments there is still some pressure exerted by FCA to maintain prices above competitive levels where competitive prices result in increased losses.

Question 18. If Congress infused several billion dollars into the System to help their financial problems, would you use some or all of these funds to lower interest rates to all borrowers, or any borrowers?

Response. There are several reasons why Congress may consider the infusion of cash financial assistance into the Farm Credit System including:

- to provide a direct subsidy of borrower interest rates on Farm Credit System loans, in which case the infusion of Federal government funds would have a direct and immediate impact in lowering interest rates to all System borrowers or to those classes of borrowers which Congress specifically identified to receive such interest rate subsidy; and
- to provide assistance to the System to reasonably assure the System can be sustained through its current severe financial distress. In this instance, the infusion of funds may not have an immediate and direct impact in lowering borrowers' interest rates. However, an infusion now of cash financial assistance may guarantee lower interest rates to borrowers over the longer-term by assuring that the System survives to continue providing a competitive, dependable, lowest-cost source of credit to the farmers and producers of this country.

E050/NB18
3/24/87

Question 19. How may districts have lowered interest rates since last October when the 1986 Amendments were enacted? As I recall, the argument then was that if Congress removed FCA's authority to set interest rates, districts across the country would lower interest rates. How many districts have reduced rates across-the-board?

Response. All districts have reduced interest rates for most loan products. Also, several new loan products with lower rates have been introduced. A few banks have retained the same rate or raised the rate of specific products. A comparison of FLBs and PCAs rates as of September 1986 and February 1987 by Farm Credit District is provided in Exhibit H.

E050/NB19
3/24/87

Question 19.

EXHIBIT H

Codes: N/A = Not Applicable
XX = Not Available

District: Springfield

	Tiers	September 1986 Rates	Tiers	February 1987 Rates (Unless otherwise noted)
FLB				
30-Day Variable Rate		N/A		N/A
Differential Rate (variable)	I	10.25	I	9.75
	II	11.25	II	10.75
	III	12.00	III	11.75
Fixed Rate				
5 Years		9.50	I	8.75
			II	9.75
Rural Housing		N/A		10.75 - 12.25
PCA				
30-day Variable Rate		N/A		N/A
Differential Rate (variable)	I	8.70 - 9.40	I	7.60*
	II	XX	II	
	III	10.50 - 13.00	III	12.10
Fixed Rate (variable)		N/A		N/A

* Rates range from a low of 7.60 to a high of 12.10.

R950/FOB1
3/20/87

District: Baltimore

		September 1986 Rates		February 1987 Rates (Unless otherwise noted)
FLB				
30-Day Variable Rate		11.25		9.50
Differential Rate (variable)		N/A		N/A
Fixed Rate				
	Tiers		Tiers	
3 Years	I	9.75	I	8.75
	II	10.25	II	9.25
	III	10.75	III	9.75
5 Years	I	9.75	I	9.00
	II	10.25	II	9.50
	III	10.75	III	10.00
10 Years	I	9.75	I	9.75
	II	10.25	II	10.25
	III	10.75	III	10.75
15 Years	I	10.00	I	10.00
	II	10.50	II	10.50
	III	11.00	III	11.00
PCA				
30-day Variable Rate		9.88		8.25
Differential Rate (variable)		N/A		N/A
Fixed Rate				
5 - 89 Days		8.05		7.00
90 - 179 Days		7.90		7.10
180 - 269 Days		7.90		7.15
270 - 365 Days		7.95		7.25
3 Years				7.45
5 Years				7.70
7 Years				8.00
10 Years				8.30

R950/FOB2
3/20/87

District: Columbia

	Tiers	September 1986 Rates	Tiers	February 1987 Rates (Unless otherwise noted)
FLB				
30-Day Variable Rate		12.00		11.75
Differential Rate (variable)		N/A		N/A
Fixed Rate				
1 Year	I	10.00	I	9.50
	II	11.00	II	10.50
	III	12.00	III	11.50
3 Years	I	10.75	I	10.00
	II	11.75	II	11.00
	III	12.75	III	12.00
5 Years	I	11.00	I	10.25
	II	12.00	II	11.25
	III	13.00	III	12.25
10 Years		N/A	I	10.75
			II	11.75
			III	12.75
15 Years		N/A	I	11.00
			II	12.00
			III	13.00
PCA				
30-day Variable Rate		8.30 - 13.50		N/A
Differential Rate	Tiers		Tiers	
Operating Loans (variable)	I	8.25	I	7.50
	II	XX	II	9.25
	III	12.00	III	11.25
Operating Loans (Fixed)		N/A	I	8.75 - 8.95
			II	10.50 - 10.70
			III	12.50 - 12.70
Intermediate Term Loans (variable)		N/A	I	8.50
			II	10.25
			III	12.25
Intermediate Term Loans (fixed)				
1 Year		N/A	I	8.95
			II	10.70
			III	12.70
3 Years		N/A	I	9.35
			II	11.10
			III	13.10
5 Years		N/A	I	9.75
			II	11.50
			III	13.50

R950/FOB3
3/20/87

District: Louisville

		September 1986 Rates		February 1987 Rates (Unless otherwise noted)
FLB				
30-Day Variable Rate		12.75		12.75
			Tiers*	
Differential Rate (variable)		N/A	I	9.25
			II	9.90
			III	10.25
			IV	11.90
			V	12.50
Fixed Rate				
			Tiers	
1 Year		9.90	I	9.50
			II	10.15
			III	10.50
			IV	12.15
			V	12.75
3 Years		10.50	I	9.70
			II	10.35
			III	10.70
			IV	12.35
			V	12.95
5 Years		11.00	I	9.85
			II	10.50
			III	10.85
			IV	12.50
			V	13.10

* All rates effective March 1, 1987.

		September 1986 Rates		February 1987 Rates (Unless otherwise noted)
PCA				
30-day Variable Rate		11.09		9.90
Differential Rate (variable)	Tiers		Tiers	
	I	10.25	I	8.90
	II	10.75	II	9.90
	III	11.25	III	10.90
Fixed Rate (variable)		N/A		N/A

R950/FOB4
3/20/87

District: Jackson

		September 1986 Rates		February 1987 Rates (Unless otherwise noted)
FLB				
30-Day Variable Rate		12.25	Ag Loans	12.25
			Rural Home	12.50
Differential Rate (variable)		N/A		N/A
Fixed Rate				
1 Year		8.15		8.95
3 Year		9.05		9.50
5 Year		9.75		9.80
PCA				
30-day Variable Rate		N/A		N/A
Differential Rate (variable)	Tiers		Tiers	
	I	10.85	I	10.30
	II	11.35	II	10.80
			III	11.80
			IV	12.60
Fixed Rate				
1 Month		8.50		8.55
6 Months		XX		8.60
9 Months		XX		8.70
1 Year		XX		8.75
2 Years				9.05
3 Years		XX		
5 Years		XX		9.65
7 Years				10.05
10 Years		10.55		10.15
Average		9.05		

R950/FOB5
3/20/87

District: St. Louis

		September 1986 Rates		February 1987 Rates (Unless otherwise noted)
FLB				
30-Day Variable Rate		12.50		N/A
Differential Rate (variable)			Tiers	
	I	9.50	I	9.50
	II	11.00	II	11.00
	III	12.50	Base	12.50
Fixed Rate	Tiers		Tiers	
1 Year	I	9.50	I	9.50
	II	11.00	II	11.00
3 Years	I	9.50	I	9.50
	II	11.00	II	11.00
5 Years	I	10.25	I	10.25
	II	11.50	II	11.50
10 Years	I	10.75	I	10.75
	II	12.00	II	12.00
5 Year Balloon		N/A	I	10.00
			II	11.25

St. Louis District - Continued

		September 1986 Rates		February 1987 Rates (Unless otherwise noted)
PCA				
30-day Variable Rate		9.655*		N/A
Differential Rate (variable)	Tiers		Tiers	
	I	10.30	I	9.90
	II	11.50	II	11.20
	III	12.70	III	12.30
	IV	N/A		
Variable Operating		N/A	I	8.50 - 9.90
			II	10.50 - 11.20
			II	12.30
Fixed Rate				
			Tiers	
3 Years		N/A	I	9.50
			II	10.50
4 Years		N/A	I	9.80
			II	10.80
5 Years		N/A	I	10.00
			II	11.00
6 Years		N/A	I	10.30
			II	11.30
7 Years		N/A	I	10.50
			II	11.50
10 Years		N/A	I	11.00
			II	12.00
Variable Term		N/A	I	9.90
			II	11.20
			III	12.30

* Average of 3 Associations.

District: St. Paul

	September 1986 Rates		February 1987 Rates (Unless otherwise noted)	
FLB				
30-Day Variable Rate		N/A		N/A
Differential Rate (variable)	Tiers		Tiers	
	I	10.50	I	9.75
	II	11.75	II	10.85
	III	12.50	III	12.00
Fixed Rate				
	Tiers		Tiers	
2 Years	I	10.65	I	10.00
	II	11.90	II	11.25
	III	12.75	III	12.25
5 Years	I	11.00	I	10.25
	II	12.25	II	11.50
	III	13.00	III	12.50
PCA				
30-day Variable Rate		11.56		10.40

R950/FOB8
3/20/87

District: Omaha

		September 1986 Rates		February 1987 Rates (Unless otherwise noted)
FLB				
30-Day Variable Rate		12.75		12.75
Old Differential Rate Program		N/A		12.00
Differential Rate (variable)		N/A	Tiers	
			I	9.75*
			II	10.25*
			III	11.00*
			IV	12.50*

* FLB rates are reduced by 25 basis points if the borrower also is a PCA borrower.

		September 1986 Rates		February 1987 Rates (Unless otherwise noted)
Fixed Rate				
Land Loan (5 Year Fixed)				9.00
PCA				
30-day Variable Rate		N/A		N/A
Differential Rate (variable)	Tiers		Tiers	
	I	10.20	I	10.20
	II	10.90	II	10.90
	III	11.50	III	11.50
	IV	13.25	IV	13.25
	V	14.20	V	13.90
Fixed Rate (variable)		N/A		N/A

R950/FOB9
3/20/87

District: Wichita

	September 1986 Rates		February 1987 Rates (Unless otherwise noted)	
FLB				
30-Day Variable Rate		N/A		N/A
Differential Rate (variable)	Tiers		Tiers	
	I	10.90	I	9.75
	II	11.50	II	10.75
	III	12.00	III (a)	11.75
			III (b)	12.00
	IV	12.50	IV	12.50
Fixed Rate				
1 Year	Tiers		Tiers	
	I	10.90	I	9.75
	II	11.50	II	10.75
	III	12.00	III (a)	11.50
			III (b)	12.00
3 Years	I	10.90	I	10.00
	II	11.50	II	11.00
	III	12.00	III	11.75
5 Years	I	10.90	I	10.25
	II	11.50	II	11.25
	III	12.00	III	12.00

R950/FOB10
3/20/87

Wichita District - Continued

PCA		September 1986 Rates		February 1987 Rates (Unless otherwise noted)
30-day Variable Rate		11.18		9.75 - 12.75 (range)
Differential Rate (variable)	Tiers		Tiers	
	I	10.00	I	9.75
	II	10.50	II	10.25
	III	12.00	III	11.75
Fixed Rate (variable)			Tiers	
30 - 119 Days		N/A	I	8.50
			II	9.25
120 - 179 Days		N/A	I	9.50
			II	10.25
180 - 269 Days		N/A	I	9.00
			II	9.75
270 - 365 Days		N/A	I	10.00
			II	10.75
Average		9.81		
Intermediate Term Loan		N/A	Tiers	
1 - 3 Years			I	9.00 - 10.00
			II	9.75 - 10.75
3 - 5 Years			I	9.25 - 10.25
			II	9.75 - 10.75
5 - 7 Years			I	9.50 - 10.50
			II	10.00 - 11.00
7 - 10 Years			I	10.00 - 11.50
			II	10.50 - 12.00

District: Texas

		September 1986 Rates	February 1987 Rates (Unless otherwise noted)	
FLB				
30-Day Variable Rate		11.00	Ag Loans Rural Homes	10.75 11.25
Differential Rate (variable)		N/A		N/A
Fixed Rate				
5 Years	Tiers		Tiers	
	I	10.875	I	9.875
	II	11.125	II	10.125
PCA				
30-day Variable Rate		10.62	Average Range	9.91 8.75 - 11.70
Differential Rate (variable)		N/A		N/A
Fixed Rate (average)		N/A	Range	7.35 - 9.95

R950/FOB12
3/20/87

District: Sacramento

	September 1986 Rates		February 1987 Rates (Unless otherwise noted)	
FLB				
30-Day Variable Rate		11.90		N/A
Differential Rate (variable)		N/A	Tiers	
			I	9.50
			II	10.50
			III	11.00
			IV	11.50
			V	12.00
Fixed Rate				
1 Year		9.00		9.00
3 Years		9.30		9.40
5 Years		9.60		9.65
PCA				
30-day Variable Rate		11.15		N/A
Differential Rate (variable)	Tiers		Tiers	
	I	10.65	I	9.86
	II	10.90	II	10.24
	III	11.15	III	10.60
	IV	11.65	IV	11.40
	V	12.15	V	12.11
Fixed Rate (variable)				
4 Weeks		8.40		9.06
1 Year		8.53		9.43
3 years		9.57		10.18
4 Years		9.83		10.29
5 Years		10.02		10.46

R950/FOB13
3/20/87

District: Spokane

	September 1986 Rates		February 1987 Rates (Unless otherwise noted)	
FLB				
30-Day Variable Rate		N/A		N/A
Differential Rate (variable)	Tiers		Tiers	
	I	10.00	I	10.00
	II	11.25	II	11.25
	III	12.25	III	12.25
Fixed Rate				
1 - 2 Years		9.40		9.40
2 - 3 Years		9.60		9.60
3 - 5 Years		9.90		9.90
PCA				
30-day Variable Rate		N/A		N/A
Differential Rate (variable)	Tiers		Tiers	
	I*	9.20/9.30/10.25	I*	9.05/9.35/10.00
	II*	10.75/11.30	II*	10.50/10.60/11.05
	III	12.30	III	12.05

* Tiered rates vary with size of loan.

	September 1986 Rates	February 1987 Rates (Unless otherwise noted)
Fixed Rate (variable)	N/A	N/A

Farm Credit Corporation of America

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303/740-4200

March 25, 1987

Senator David L. Boren
Chairman, Subcommittee on Agricultural Credit
United States Senate
Russell Building
Washington, D.C 20510

Dear Chairman Boren:

Enclosed are the responses to your questions dated March 24, 1987, regarding restructured loans. I have also provided a copy of the Guidelines and Definitions for Restructuring Troubled Loans. Ten districts and the CBC have adopted this policy.

Most districts are taking major steps to address this issue. Special groups of workout specialists have recently formed in most districts to work with borrowers in financial distress. We anticipate significant progress in restructuring loans during 1987.

Thank you for your interest and concern.

Sincerely,

Brent Beesley

H. Brent Beesley
President and
Chief Executive Officer

HBB/do

Enclosures

RESPONSES TO QUESTIONS FROM SENATOR BOREN

Question 1. How many restructured loans are there Systemwide?

Response. As of December 31, 1986, the System reported 3,794 restructured loans. Restructuring has taken the form of: asset transfers, granting of equity interest, reduced principal, reduced interest rates, extended maturity dates, and combinations of the above mentioned.

Question 2. How much have the restructured loans Systemwide reduced the total principal?

Response. The complexity of FASB 15 and the availability of data make it difficult to answer your question. What we can provide you is the loan balance at the time of restructure and the losses recorded as the result of the restructure. As of December 31, 1986, on the loans restructured, the loan balance prior to restructuring totaled $750,179,000.

We only have information on losses recorded on $735,096,000 of the $750,179,000 total. Losses recorded on the $735,096,000 amounted to $119,531,000. The $119,531,000 is not all principal reduction. It also includes reduction in interest, legal fees, insurance, etc. Unfortunately, the data we have available does not allow us to report just reductions in principal.

GUIDELINES AND DEFINITIONS FOR RESTRUCTURING TROUBLED LOANS

General

"The banks and associations of the Farm Credit System will administer troubled accounts with the objective of utilizing FmHA loan guarantees and other loan restructuring measures, including participation in federal- and state-funded interest rate buy-down programs, as preferred alternatives to foreclosure.

Restructuring should be accomplished on a case-by-case basis when:

- The borrower has acted in good faith to manage his business affairs and has been cooperative with the bank or association;
- The borrower can present a plan with reasonable assumptions showing a high probability of return to financial viability as a result of the restructuring; and
- The alternative chosen will minimize any loss that will be borne by the other borrowers/stockholders of the bank or association."

(Resolution #7 was unanimously adopted by the FCS Bank Chief Executive Officers on March 24, 1986, and the FCCA Board of Directors on April 2, 1986.)

The objective of these System Guidelines and Definitions for Restructuring Troubled Loans is to provide a reasonable alternative to foreclosure and property acquisition by:

1. Generating the greatest return of principal and interest to the FCS while protecting the interests of other stockholders.
2. Encouraging FCS participation in federal and state programs which offer relief to financially stressed borrowers.
3. Standardizing key definitions which differentiate between normal forbearance and troubled debt restructuring and encouraging consistency in application.

Forbearance

Forbearance is the act of a creditor who refrains from enforcing contractual obligations, rights, or claims against borrowers when a debt falls due. Loan servicing actions such as rescheduling of principal and interest payments, change of installment dates, temporary forbearance of payments due, renewal of unpaid principal and interest, agreed carryover, waivers, subordinations, etc., are examples of forbearance. The common characteristic of this type of restructuring is that the lender receives all that was agreed to in the original contract. There is no special accounting treatment since no concessions are granted.

Forbearance shall continue to be offered on a case-by-case basis to assist worthy borrowers provided the borrower is:

1. Acting in good faith to manage and operate the agricultural business properly;
2. Applying the proceeds of production (minus reasonable and necessary living and operating expenses) to the payment of debt obligations;
3. Maintaining the buildings, improvements, and farm assets in a reasonable state of repair; and
4. Working out of the existing situation and has the resources to operate the agricultural business efficiently.

Troubled Debt Restructuring

"A restructuring of debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. That concession either stems from an agreement between the creditor and the debtor or is imposed by law or a court." (FASB 15)

The common characteristic is that the lender negotiates with the borrower and receives in return less than the lender has agreed to in the original loan contract. A Compromise of Indebtedness described in Section 4512 of the Regulations is a troubled debt restructuring. Troubled debt restructuring is subject to special accounting treatment as defined in Financial Accounting Standards #15.

Examples of loan servicing actions which constitute troubled debt restructuring are:

1. Transfer of real estate, receivables, or other assets to the lender to fully or partially satisfy a debt, including a transfer resulting from foreclosure or repossession.

2. Grant an equity interest to the lender to fully or partially satisfy a debt, unless the equity interest is granted pursuant to existing terms for converting the debt into an equity interest.

3. Modify the terms of a debt by:

   - Reducing the stated interest rate for a period of years, up to the remaining original life of the debt.

   - Extending the maturity date at a stated interest rate lower than the current market rate.

   - Reducing the principal amount of the debt.

   - Reducing accrued interest.

Troubled debt restructuring is to be considered on a case-by-case basis. The analysis shall document the potential cost and benefits of restructuring to the bank or association involved versus the loss which would likely occur using traditional methods of asset liquidation and foreclosure. Restructuring should be considered when the System will otherwise take a loss.

As a minimum, the following factors are to be used:

1. The borrower is acting openly and in good faith, is caring for the collateral, has pledged or agrees to pledge all assets of reasonable value, has good farm management skills, and has a lifestyle adjusted to the current financial situation.

2. Complete and current balance sheets and income and expense statements will be obtained, analyzed and verified.

3. Complete and current appraisals and field reports should be made and analyzed. A projection of the lender's net realizable value of the collateral is to include expected movement of the market and the local level of stress.

4. A complete legal audit of the loan file is to be made to assure the sufficiency and accuracy of all loan documents.
5. The borrower is to present a workout plan and cash flow analysis using reasonable projections showing a high probability of orderly debt retirement as a result of the proposed restructuring.
6. Communication between all creditors is expected, especially the major long- and short-term lenders. Concessions from other creditors should be negotiated.
7. FmHA loan guarantees and interest rate buy-down programs or any other federal- or state-sponsored financial assistance programs should be utilized to the extent practicable.
8. The borrower should be advised to consult legal and tax counsel prior to finalizing troubled debt restructuring.
9. Normally, principal should not be forgiven; it may be set aside on a deferred, reduced, or non-interest bearing note with a definite maturity.
10. Generally, the least cost alternative should be selected. While forbearance may be appropriate, debts that can clearly be collected through other means should not be restructured.

When restructuring troubled debt, certain operational issues should be addressed.

1. Troubled debt restructuring should be administered through one main focal point in each district. Districts are encouraged to establish a specialized loan restructuring unit to assist, coordinate, and control such cases. Prior to delegating restructuring authority to associations, districts should establish clear understanding and controls to realize consistent results.
2. Each district should develop a system to follow up and supervise completed troubled debt restructuring actions to ascertain the case-by-case effectiveness.

3. Accounting treatment of all troubled debt restructuring shall be in accordance with Generally Accepted Accounting Principles.

4. Each district general counsel should review applicable state laws prior to implementation of these guidelines.

5. Nonaccrual loans shall be reviewed in accordance with Section 307 of the Farm Credit Act Amendments of 1985.

6. Periodic reports should be developed to provide the number and volume of loans and concessions granted according to each type of forbearance and troubled debt restructuring. The reporting data will be used to assess the overall effectiveness of these guidelines

AGRICULTURAL CREDIT

Farm Credit Proposals

THURSDAY, MARCH 26, 1987

U.S. SENATE,
SUBCOMMITTEE ON AGRICULTURAL CREDIT,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The subcommittee met, pursuant to notice, at 11:03 a.m., in room SR-332, Russell Senate Office Building, Hon. David L. Boren (chairman of the subcommittee), presiding.

Present or submitting a statement: Senators Boren, Boschwitz, and Lugar.

OPENING STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM OKLAHOMA

Senator BOREN. The subcommittee will come to order.

I apologize. We had two votes that occurred and that delayed us getting started this morning, and I know some of you have planes to catch. I will defer my entire opening statement to you this morning, but simply say that last month the subcommittee heard testimony outlining the history of the Farm Credit System, with the financial condition of the System.

The purpose of today's hearing is to examine specific proposals and suggestions for dealing with the problems confronting the System. Out of the suggestions that we hear today and in the near future, we hope to develop a legislative proposal which will resolve the System's problems and which will be beneficial to the farmer-borrowers of the System and other lenders.

There is no question that we have a serious problem in the Farm Credit System, which is the Nation's largest single agricultural lender, as all of you know. In 1986, the System registered a $1.9 billion loss. For the second consecutive year, loan volume declined more than $12 billion, at the rate of $1 billion per month, leaving the System with gross loans outstanding of $54.8 billion at year-end.

Of outstanding loans, $5.7 billion were nonaccruing loans, and another $5.7 billion were considered other high risks in terms of category. The relative increase in the share of nonaccrual loans as a proportion of total assets, increases in other nonearning assets, including acquired property and the significant proportion of high coupon bonds remaining in the System's portfolio. Competitive pressure on the demand side is also squeezing interest earnings.

In addition to aggregate financial accounts, certain banks are in far worse shape than the aggregate statistics suggest. For example, 5 of 12 Federal land bank's had negative net interest income. Further, seven Federal land banks and one production credit association required the use of regulatory accounting principles [RAP] to prevent impairment of borrower stock.

I think we all understand the vicious circle in which we find ourselves. Interest rates are remaining higher than some competitors. Those borrowers in the best financial shape are able to get credit at lower rates of interest elsewhere and are leaving the System. Those under the greatest financial stress remain in the System, interest rates continue to stay above where they should in order to try to stem the amount of losses, and this again drives more of the high-quality borrowers out of the System. We are in a vicious cycle that is getting worse.

Failure to act with dispatch will only increase the long-term costs to the taxpayers, so we must find and work toward a comprehensive solution to the problem. At the same time, we must all understand that there is going to be no blank check written to the System. There are going to have to be very significant reforms to avoid the kinds of problems that we are now facing.

Obviously, mistakes have been made in the way in which we have set interest rates in the past, going away from the marginal interest rate back to the average. This resulted in lower than normal interest rates for a period of time and it resulted in more borrowing. We changed the ratios and the method of making loans in terms of how large the loans would be that we could give, moving away from the old rule of 65 percent of agricultural use value.

So we have made mistakes in the past that have helped create the problems we now face. We are dedicated to the proposition that when we try to solve the financial problems we now face solve them in a fair enough way that the System will not have to return year after year. Some reforms are going to have to accompany financial aid so that we can assure the agricultural communities and the taxpayers that we are not going to repeat the mistakes of the past again.

We have a System that is based upon the concept of farmer participation at the local level, that is a concept that is very important, a concept that must be maintained. We have always felt there was a community there, people understanding each other and knowing the personal characteristics of the other farmers, the members, the borrowers that have to be maintained.

Unless reforms are made very soon, the FCS will face a bleak future. Estimates are that loan volume will decline substantially in 1987 and losses are estimated to be in the neighborhood of $400 million per quarter. At the end of 1986, the System has only $1.4 billion of surplus remaining. It's not hard to see that this will be gone by the end of the year.

WHY WE CAN'T WAIT

In simple terms, the longer we wait to provide Federal assistance, the more it will cost. The problems confronting the Farm

Credit System are worsening daily. The longer we delay action, the more it will cost because the delay will weaken the district banks and associations that are still relatively healthy.

Despite urgings in 1985 and 1986 by some of us, Congress and the administration failed to address the problems of the Farm Credit System and failed to put the System back on the right track. If we had acted sooner, we could have prevented the decline in loan volume of $12 billion in 1986 alone. If the System had received the interest income on this $12 billion for the full year, the System could have reduced 1986 losses by $1.2 billion (assuming an average interest rate of 10 percent), thereby resulting in losses of only $700 million, instead of $1.9 billion.

Without Congressional action, the System will remain caught in a vicious cycle. Higher quality borrowers are leaving the System for two reasons. First, interest rates are cheaper elsewhere. Second, these borrowers fear that they will lose their stock if their local associations are liquidated. As these borrowers leave, interest income is reduced, thereby necessitating higher interest rates for the remaining borrowers. This puts more pressure on the remaining borrowers and forces many of them to be unable to make the higher interest payments. As more of these borrowers' loans are liquidated, pressure is again added to remaining borrowers as it has become difficult to move acquired property due to the general economic condition. Today's current situation exactly parallels the problems confronted during the Depression. The longer we wait, therefore, the more the problem is exacerbated—more damage is done to the System and the more it will cost to return the System to a profitable position. We simply can't wait any longer!

NO SIMPLE BAIL-OUT

Any Federal assistance provided to the System will be in the form of a loan. As has been done with the System since it began in 1916, any assistance provided directly to the System will be in the form of a loan. During the thirties and forties, the System was given financial assistance, but they had paid every penny of that back by 1968.

I certainly am not in favor of giving the System a blank check. There will have to be significant reforms in the System. The System will have to earn the temporary help by making changes. In addition, the System must be put in the position that it won't be back in here asking for more money in a few years. Reform that will avoid repeating the same mistake must be made.

For example, there is no doubt that the major reason the System got into its present condition is the method used during the seventies to price interest rates. Prior to 1971, the System was required to base interest rates on the most recent bonds issued by the institution. In this manner, the interest rate offered to farmers and ranchers closely reflected current financial market conditions, thereby permitting System interest rates to track those of other competitors. After the 1971 act, however, interest rates were based primarily on the average cost of bonds the bank had issued. By using the average cost, interest rates in the seventies and early eighties were artifically lower than those for other commercial lenders and most recently they have been substantially higher than other lenders'. In 1981, for example, the prime rate was 18.87 percent. The interest rate for commercial banks at that time were 18.5 percent for operating loans, while the interest rate offered, on average, by production credit associations was 14.46 percent for operating loans. On averge, in 1981, the interest rates for agricultural real estate loans were 15.42 percent by commercial lenders while the Federal land banks were offering 11.27 percent. It is now clear that the System, in the 1970's and early eighties used the average cost pricing method to gain an unfair advantage over commercial lenders and encouraged farmers to borrow too much money. If there is to be Federal assistance provided to the System, we must be assured that this will never happen again.

Another reason the System is facing difficulties is the change in 1971 of the amount of money that could be loaned on a farm. The 1971 act increased this amount to 85 percent of the current market value from 65 percent of the normal agricultural value. In many cases, this immediately doubled the amount of money a producer could borrow. It worked well as long as land values were going up every year, but the minute that stopped, the bottom fell out for farmers who had increased their debt in the seventies. We should also gradually change this back to 65 percent of the appraised agricultural value as new loans are made. Only in this way will we prevent the System from loaning more money than a farmer can hope to repay.

Because the Farm Credit System is restricted to making only agricultural loans and loans to farmers, ranchers, and their cooperatives, the success of the System depends on the succcess of agriculture alone. When the agricultural economy is depressed, the System faces difficulty. In addition, the main reason the System was established was to provide long-term agricultural real estate loans. Unlike other commercial lenders, a substantial portion of the System's loans are long-term real estate loans. Seventy-three percent of the System's total outstanding loans are long-term real estate loans, compared with 28 percent of outstanding loans for commercial banks. This obviously puts greater stress on Federal Land Bank Associations than most commercial banks experience. Despite this, the FCS must not have an unfair advantage over other lenders. If we fail to make the reforms mentioned above, the FCS will be able to under-cut interest rates offered by other commercial lenders the moment interest rates start rising again. In addition to modifying the System's method of pricing interest rates, we are also exploring the possibility of including in the farm credit bill, the establishment of a secondary market for agricultural loans that would be available to all lenders. A secondary market could help even out the playing field by giving other lenders the opportunity to make long-term real estate loans at reasonable rates. This could also benefit farmers and ranchers by providing more competition in real estate loans, thereby reducing interest rates.

I believe that relief for the Farm Credit System should also be coupled with a program to reduce interest rates for all agricultural borrowers. It would not be fair to address only the problems of Farm Credit System borrowers.

Any assistance package should include certain principles. First, any financial assistance must be conditional on substantial reforms, as I have mentioned, that will prevent a repeat of the same problems in the future. There can be no blank check.

Second, we must enact a long-term solution to the System's problems; third, we must provide some form of interest rate buy-down or principle reduction relief for all eligible farmers and ranchers, regardless of their lending institutions. I think it would be wrong simply to help the farmers that are borrowers from the Farm Credit System without addressing the legitimate needs of other farmers who are borrowing elsewhere.

Fourth, we must ensure that the System does not have an unfair advantage over other lenders by providing a more even playing field; fifth, we must strengthen the control the farmer-borrowers have over the System; sixth, we must insure that the System will not be just another large bank and prevent extreme centralization of System institutions; seventh, we must restrict the System's lending authority to agriculture, and, finally, there must be no more delays in dealing with the problems of the System.

I welcome the witnesses today. Again, I apologize, Senator McClure, with the two votes on the floor and an early meeting that occurred over trying to resolve the current banking legislation, we were delayed in getting started and I appreciate your patience in waiting. I am going to call upon you and then I will turn, I might say, to Mr. Kleckner and to Mr. Huff, somewhat out of order, because I know that they have airline reservations and are under some pressure.

Senator McClure, we are really happy to have you this morning. You have been an outstanding leader in this whole field. You have consistently shown your concern again and again for agriculture and your knowledge of the Farm Credit System in particular, and we welcome you.

STATEMENT OF HON. JAMES A. McCLURE, A U.S. SENATOR FROM IDAHO

Senator McClure. Mr. Chairman, thank you very much. I of course find myself in a great deal of agreement with what you said in your opening statement and with some of the solutions which you have suggested, the parameters or conditions for the solutions.

I do not mean to abuse the committee or you, Mr. Chairman, by making an overlengthy statement, but I do believe there are some conditions that exist in the Northwest that I would like to outline for the committee, because they are somewhat different than they are in other places, otherwise I would not take your time to deal with what is the generalized background which you understand perhaps better than anyone else in the Nation.

First, I would like to thank you for your efforts in holding this hearing. It is time that the Congress take action to deal with what has become a very critical issue to American farmers and ranchers. The issue is one which we have visited twice in as many years—how to deal with the enormous losses which are crippling the largest agricultural lender in the United States—the Farm Credit System.

At the same time, Mr. Chairman, I want to emphasize that the farm problems facing this country are affecting all entities which provide financing to rural America. Rural banks, insurance companies, Federal land banks, production credit associations, and the Farmers Home Administration; have all found themselves with an increasing number of problem loans, nonaccrual loans and loan losses.

Declining profitability in agriculture is the basic problem facing farmers and ranchers. With the decline in net farm income starting in the early 1980's, farm land values have declined every year since their peak in 1982. In my district, the 12th Farm Credit District located in Spokane, Washington, land values have declined over one-third from their 1982 peak.

I believe that we are near, but not yet at the bottom of the land value decline. The drop in value will not stop until agricultural earnings either pay for the land or other factors, such as purchase by investors or long-term debt restructuring by lending institutions provides a price floor.

Farm bankruptcies, loan delinquencies and foreclosures have increased annually thus increasing the stress on agricultural lenders. Because the Farm Credit System is the Nation's largest agricultural lender and by statute must lend only to agriculture, its fortunes have followed the farmer downhill. Production credit associations and Federal land banks are in more serious trouble because they do not have consumer lending and nonagricultural commercial business to offset their agricultural portfolio.

System banks' fortunes mirror the distress in our farming areas today. For instance, in the 12th district, bankruptcies of Federal land bank borrowers increased districtwide from 66 in 1982 to 385 in 1986. Federal land bank delinquencies increased from 1,766 or 4.2 percent of total loans in 1982 to 3,759 or 11.1 percent of total loans in 1986. Loans called for foreclosure increased from 141 to 454 during the same time period.

Another measure of declining repayment capacity is the increase in adversely classified loans. Spokane's Federal land bank adversely classified loans increased over 350 percent from December 31, 1983 to December 31, 1986.

Not all of the problem is confined to the Federal land banks. Production credit associations have had their problem too. The Spokane Federal Intermediate Credit Bank received $135 million in financial assistance in 1985 through the sale of nonperforming loans to the Farm Credit Capital Corporation. This assistance was in the form of a loan participation and nearly $90 million has been repaid to the contributing banks.

Even with this assistance, the Spokane Federal Intermediate Credit Bank continues to show signs of severe financial stress. Decline in loan volume and the total number of loans continues unchecked. The 12th district also shows a serious decline in loan quality. Since 1982, short-term PCA loan volume declined from a high of $1.8 billion loaned to 18,000 farmers down to the current level of $500 million loaned to 7,000 borrowers.

I do not believe that the 12th district is operating in a vacuum. Systemwide losses are similar in all but perhaps two or three districts. The System's problems are the same as the 12th district's:

large amounts of nonearning assets, excessive administrative expenses, outstanding high-priced debt and an inability to deal well with its problems.

The System has acquired properties of $1.110 billion and is carrying $8 billion in nonaccrual loans. It also has another $5 billion; in loans classified as high-risk. Of 58,616 nonaccrual loans, about 1,500 have been restructured as of February 19, 1987. That is about 3 percent of the nonaccrual loans.

Acquired property is equally problematic for the System banks. Disposal of this volume in the currently depressed market would likely drive land values even lower. I believe that an aggressive, proactive inventory property disposal program, such as the St. Paul district is followed, will move the land out of Farm Credit System ownership, stabilize land values and bring investors into the market to support farm land values.

The System's cost of doing business is also too high. The System has seen a significant loss of customer base but has not been able to reduce its annual overhead of about $800 million. It is true that, due to increased regulatory control procedures and an increasingly difficult lending climate, much extra time and effort must be spent at local associations. However, this still appears to be an overwhelming cost for this size of bank.

The problem of high priced debt is a most troubling one. The System financial officers during the "go-go" days of the 1970's and early 1980's bet that inflation would continue and sold long-term high-interest rate bonds with no call provisions. These bonds are now locked into the rate structure until the year 2003. Because they have no call provision, they cannot be paid off without the payment of a substantial premium to the bond holders. This would only increase the total cost of System debt.

In 1986, we in Congress thought we had found a way to address this issue. In late 1986, Congress passed amendments to the Farm Credit Act which would allow the use of regulatory accounting practices to sustain the System. Congress allowed System banks to purchase these bonds back and use regulatory accounting practices to spread the costs over 20 years. Unfortunately, the Farm Credit Administration has made the use of regulatory accounting practices so difficult and onerous that few district banks have elected to use it. Only when the Farm Credit Capital Corporation takes over a bank does a bank decide to use RAP.

The fourth problem, as I see it, is that System banks have difficulty in dealing with System problems. When Congress passed the Farm Credit Amendments of 1985, it did so after receiving assurances from the Farm Credit System that they would honor the loss sharing agreements between and among banks in an effort to help sister banks which were in trouble. In fact, some banks did honor these agreements and some did not. There are still nonstock assets within the System which banks will not share.

Recent Farm Credit System meetings have not proven productive from the standpoint of System unity behind an answer to their collective problem. It appears that the System bank presidents want the positive side of being a farmer owned cooperative with Federal Government agency status, but not the down side. They wanted to compete on the market when they could undercut commercial banks and insurance companies, and now, under pressure, they are looking to the Federal Government to hand them a solution, most likely in the form of an immense amount of Federal funding.

I for one want to see the benefits of any Federal funds which may be channeled into the System go to the benefit of the borrower. I want to see the interest rates decline, not just hear that the Farm Credit Administration will not let the banks lower their interest rate. I want to see district banks change their attitudes toward farmers in trouble and follow a policy of restructuring, refinancing, and extending debt over 20 to 40 years to help farmers in difficult situations. I want to see control returned to the local associations and removed from the district level. I want to see the Farm Credit Administrator completely out of day to-day decisionmaking and only hear from FCA if they are taking regulatory action against a bank.

I believe that any legislation involving Federal funds for the Farm Credit System must contain these things: Number one, an overriding position of restructuring farmers' debts, not liquidation and foreclosures; secondly, a purging of the high interest rate, long-term debt from the System to reduce the interest rates to those farmers who did not benefit from debt restructuring; third, an inventory reduction program instituted in all district banks which will move acquired lands out of inventory, into the marketplace without reduction in land values; fourth, the return of control to the local associations within the confines of the overall regulatory prescriptions of the Farm Credit Act; fifth, borrower stock must be guaranteed to avoid further borrower flight from the System; and, sixth, a way must be found to help those farmers who borrow outside of the Farm Credit System.

I favor the restructuring of debt for farmers outside of the Farm Credit System also. It is not fair for only those who are in the System to benefit from Federal Government involvement in agricultural refinancing. The creation of a secondary market for commercial banks and insurance companies is sound and is one which I support.

For lending institutions, a secondary market for agricultural mortgages will give lenders needed liquidity to continue to provide long-term agricultural credit at competitive rates to qualified borrowers. To date, farm mortgages have not been pooled and packaged into securities to any substantial degree and as a result no major secondary market has developed for buying and selling farm mortgages. With the assistance of Federal initiatives, the secondary market concept has worked well for other long-term mortgage investments such as residential mortgages.

I believe that it will also work well in agricultural mortgages, providing needed liquidity to agricultural banks and others. The only concern I have with placing this in the Farm Credit System is the potential for increased concentration of risk in the future. Perhaps it can be structured in a manner which will avoid this problem.

I believe that these things can be done, but the attitude of both the Farm Credit System management and the Farm Credit Administration must change. The adversarial relationships between System banks, between the FCA and the System banks, and among the System banks, the FCA and Congress must change. The litigious nature of the banks and the FCA must be put aside to face the greater challenge of providing relief to the borrowers which are the backbone of the System.

I hope that this subcommittee will review my suggestions with an open mind and allow me to work with you, Mr. Chairman and other members of the subcommittee, to find an answer to what is a very vexing but very fundamental problem.

Mr. Chairman, I look forward to working with you and the members of this subcommittee.

Senator BOREN. Thank you very much, Senator McClure. I think you have obviously made some excellent suggestions. I heartily approve of what you said in terms of the need to restructure this debt, to also have aggressive programs for making sure that disposal of assets is not done in a way which further collapses and erodes land values, it is absolutely essential, and also the need to find a mechanism for purging this long-term high-interest portfolio so that we can bring the interest rates down for all concerned.

Also, of course, you have been taking the lead along with our ranking member, Senator Boschwitz, and others in working on the protection of the borrower stock, and I certainly appreciate your efforts along that line.

Let me ask if other members of the committee have questions. Senator Boschwitz.

Senator BOSCHWITZ. I want to ask Senator McClure why only 3 percent of the nonaccrual loans in your district, the 12th district, Spokane, have been restructured?

Senator MCCLURE. There has been no real attempt, as I see it, to—it takes aggressive leadership to get that done. As you know, Senator, the St. Paul District has done a great deal more under very aggressive leadership, calling all borrowers and lenders together to restructure loans where everyone that is involved shares in the decisions that are made. That takes positive, strong leadership and it will not occur just in the absence of leadership, and I think that is exactly what we are seeing.

Senator BOSCHWITZ. I do not know what kind of leadership you have in your district, but it would seem to me that you might need some new leadership if you cannot get loans restructured.

I might say, as we discussed briefly going back to the Senate for the vote, I am losing a little patience listening to the problems of the Farm Credit System. I have listened and listened. I am familiar with the problems of the Farm Credit System and I know what caused the problems. Yes, there were some bad loans that were made.

Frankly, the Farm Credit System's cousins in the regular banking system did not shine during that period either. There are some little loans to Mexico and a few other countries of much less creditworthiness than Mexico which really threaten the entire banking system, so that the hearing might even be extended to consider that.

Clearly, what the solution to the Farm Credit System is, in my judgment, is not very difficult. You simply have to get some aggressive people who are willing to restructure loans, and who are willing to act in a very positive way. I cannot tell you how enthusiastic

I am about the fellow in St. Paul, Larry Buegler. Sure he may have done some things that perhaps politically were not wise. He put an ad in the Wall Street Journal that said buy North Dakota for 4.9 percent. Of course, we in Minnesota would think that is a little high. [Laughter]

Nevertheless, and you need a big downpayment to get that kind of interest rate and you have to pay over the appraised value and so forth, so there was no bargain involved there.

Senator McCLURE. There was no bargain, but it also is working.

Senator BOSCHWITZ. You bet it is working. It is like selling an automobile, you know. You can go and borrow and if you pay a high-enough price, you do not even have to pay interest. But they always tag in the end, you know, that the price is a little higher if the interest is a little lower.

What I think the Congress should do is guarantee the B stock in order not to have more borrower flight. Then we should guarantee that the Farm Credit System has to go out into the open market and borrow some money to refurbish or to supplement its capital account. We will guarantee that for a while and they will get over this problem, but they need good management.

Senator McCLURE. Certainly they need good management, but, Senator, I think the speculators and the bad farm managers, those who are speculating on land value appreciation alone, and the bad managers who simply could not manage, have already been weeded out of the System in main. Let us not make policy for the worst cases, let us make policy for the great bulk of farmers, and to me that means not just the Farm Credit System borrowers but all farmers who go into the credit markets for whatever reason.

We have not yet, in my opinion, reached the bottom of land values, although we may be approaching that, but we also have another 10, 15, or 20 percent of farmers who may not survive the next year or two. The borrowing and income statistics clearly show that.

I am not sure that we should sit, even though another year or two may bring about the end of the restructuring and the beginning of the next base of expansion in farming, I am not sure we ought to sit and see that 10, 15, or 20 percent of further restructuring taking place if there is an alternative which we could apply as we look at the Farm Credit System. To me that means at least in part allowing those farmers who accumulated too much debt, in order to cash flow to meet their debt repayment requirements on an annual basis or have reduced their debt equity ratio to the point where they no longer are viable borrowers, we ought to be exploring whether or not we could restructure that total debt on the longer term basis to lower their debt equity ratio and to lower their cash flow requirements so that they can cash flow and can qualify and survive for the next year or two, and I think that is a possibility for a substantial number of farmers and we ought not to ignore that possibility.

Senator BOSCHWITZ. I have no objection to restructuring and doing so in a sensible and logical fashion. You ought to go back and make that speech to your friends in Spokane.

Senator McCLURE. I have. They have heard it.

Senator BOSCHWITZ. Is that right?

Senator McCLURE. They did not listen, but they heard it.

Senator Boschwitz. Well, inaction is going to bring down the Farm Credit System. We simply have to get out and restructure those loans. We have to move the land in such a way, as you say, that we do not slow the market and we need better management.

Senator McClure. The Chairman made a point and I tried to make the same point, and I would like to return to it. We should not be concentrating only on those borrowers who are within the Farm Credit System. If we did that, we might well create a favorite set of borrowers in the marketplace and change competitive relationships in an unfair manner, and I think it has got to be farm credit-wide, not Farm Credit System-wide.

Senator Boschwitz. You know, we do not have control entirely of all the elements of the life insurance companies.

Senator McClure. I do not want to control them.

Senator Boschwitz. 25 or 28 percent of the loans are in private hands on contract for deed and those folks have been pretty flexible. It is some of the people in the Farm Credit System, apparently the people up in Spokane, that have not been. Three percent of the nonaccrual loans you say have been restructured in your district.

Senator McClure. Yes.

Senator Boschwitz. That is outrageous.

Senator McClure. We agree.

Senator Boschwitz. You know, I am not sure of this, but perhaps the Chairman feels that we can control all farm lending. I am not sure the scope of our subcommittee is such that we can or that we want to pass that much legislation.

Senator McClure. Could I change that just a little bit, because I am not sure what I seek is control of all farm lending, but I would like to see us, whatever we do, make available farm credit to those who are not now in the Farm Credit System so that we do not create two classes of borrowers, those that are outside the System and those that are inside the System.

Senator Boren. If we figure out a way that really reduces the interest rates for those borrowers within the System and——

Senator McClure. The change would be most dramatic for those that are in the System and they are the ones perhaps most in need.

Senator Boren. But we still should make sure that we have the benefit of the lower interest rates. If we have a program, other lending institutions should also qualify for the general program.

Senator McClure. That is right.

Senator Boschwitz. Together we have done that kind of legislation before, and I suppose we might do it again. But the Farm Credit System should not wait. Perhaps what the Farm Credit System needs is to have a management consultant come in and come up with some suggestions and hire some more aggressive people and not people who are going to sit on their hands.

I must tell you that I am losing my patience for the Farm Credit System. I have listened to them so much. I keep listening and listening, and then I see the guy who comes from the banking system come in in St. Paul, and within the rules, the regulations and the statutes, he turns the St. Paul—which is the largest district—around and gets it going. That is what should happen in all the districts and then we can, I think very rapidly act to provide the adequate capital and to protect the B stock.

Sure, every farmer should be protected but, very frankly, there were two classes of borrower, Senator, when some of those loans were made. As I look at the rates of interest that occurred over the years, back in 1980, they were charging 11 percent, and in 1979 they were down under 10 percent, and the inflation rate was higher than that.

Senator **Boren**. In the System, in the Farm Credit System.

Senator **Boschwitz**. In the land bank, and the PCA's on this chart. There is great incentive to borrow. We cannot go back and fix all of that, but we need to have some people who are going to just take the bull by the horns and not wait for Congress to act. We will all get old and gray doing that.

Senator **McClure**. Again, I really believe that it is probably true that the people who did the worst in terms of borrowing succumbed to the lure of the interest rates that were below market. Those people were in the main speculative borrowers and they have already in the main been eliminated. They are not the ones we are talking about.

Senator **Boren**. They have been washed out of the System already.

Senator McClure, we really appreciate you coming in. I think you have had some excellent suggestions and we appreciate your testimony.

Senator **McClure**. Thank you very much.

We look forward to working with you.

Senator **Boren**. Thank you very much.

We are going to move now out of order, because I have been told that there are two of our witnesses that are on tight schedules, who have to catch airplanes if they are to get to where they need to go today.

I will ask Dean Kleckner to come forward now, the president of the American Farm Bureau Federation. We very much appreciate your being with us and again I apologize to you that the Senate schedule got somewhat disrupted today.

STATEMENT OF DEAN KLECKNER, PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. **Kleckner**. Thank you, Mr. Chairman. I am Dean Kleckner, president of the American Farm Bureau. I am a farmer from Rudd, Iowa. I also borrow money from the Farm Credit System in the Omaha district.

I really appreciate the opportunity to appear before this committee again for the second time in the past month. On the previous occasion, I had no specific suggestions about solving the Farm Credit System problems, only our opinion about what caused the problem. I mentioned that I had appointed eight State Farm Bureau presidents to focus on the Farm Credit System. Yesterday, that committee made some recommendations and our executive committee endorsed their ideas.

I want to say that our first and foremost interest is to help farmers and ranchers. Admittedly, we do not have all the answers, but we do have several concepts we believe will provide assistance to both member-borrowers and to the System. We are not set in concrete on these ideas, but we firmly believe someone had to step forward and surface some proposals so that Congress can move along in addressing the Farm Credit System problem.

Mr. Chairman, I want to compliment you on your participation in that process. I think had you not taken the lead and kept pushing for early consideration of the problem, we believe Congress might again have waited until the last hour to do anything, so my congratulations.

The Farm Bureau continues to seek long-term solutions to the problems of the System, not more short-term band-aids. We must separate the problems emanating from loans made in the past from the need to maintain a viable system in the future.

We believe the following five goals must be met in whatever assistance program is finally pursued by Congress:

They are to maintain a viable Farm Credit System for agriculture; second, provide adequate credit at competitive rates for member-borrowers; third, protection of the value of member-borrower stock; fourth, effective restructuring of member-borrower loans; and, lastly, disposal of acquired property without adversely affecting asset values. And you and Senator McClure I think mentioned those things also.

The primary components of an assistance program, as we see it, are the following: The System needs a Federal Government infusion of capital. The longer the delay in infusing capital, the more the infusion will cost, the more trouble the System will be in, and the more the "healthy" district banks will be weakened.

This would allow the System to deal with debt problems that are the results of past decisions and be a viable credit supplier in the future. Without assistance, a substantial portion of the System cannot be a viable supplier for the long term. Repayment of Federal Government capital is expected eventually, but not necessarily in the short term.

Second, we oppose further transferring of capital between districts. Substantial transfers have already been made and total System capital is inadequate to solve the System's financial problems.

Third, at this point we see three principal ways to target a Federal Government infusion. The first way is by purchase of problem loans, problem assets and high-cost bonds by the capital corporation. This would allow the districts to move to a "clean bank" status and would allow them to again be profitable much more quickly. We also assume that once a district bank had fewer problem loans and a lower overall cost of money, it would reduce the interest rates charged to the borrower.

The second way we see is a direct capital infusion into the troubled institutions aimed at reducing interest costs. This would provide capital to the System and substantially improve its net interest income. The district could then restructure loans and lower interest rates.

A third way that we see would be a combination of interest rate relief for borrowers and the System plus a capital infusion into the troubled institution. This would focus the interest rate benefit more directly to the borrower. The System's net interest income could also improve and some capital would be provided to the institutions with the most depleted capital position.

Presently, we are not tied to any of these specific proposals, but——

Senator Boren. When you talk about the last, you talk about taking those first two actions within the System and then some sort of an interest rate buy-down program that commercial banks as well would be eligible for, is that correct?

Mr. Kleckner. We would think that that certainly could, that you should look at that.

The fourth component of an assistance program would be governmental guarantee of current member-borrower stock value, that should be part of the package. This is needed to help stem the loss of loan volume as well as shore up the confidence of the borrowers and therefore decrease borrower flight.

The fifth component that we see is when Federal Government money is infused, the System should be required to use only generally accepted accounting principles. This would facilitate complete understanding of the financial condition of the System. Congress, after all, only turned to RAP last year when they were trying to delay the inevitable, so we think that GAAP ought to be used so there is no confusion about the status of the System.

The sixth point, we support the opportunity for merging FICBs, the land banks and the bank cooperatives within or across districts only after full disclosure and member-borrower approval.

The seventh point, we support further consolidation of local offices only if such consolidation does not unreasonably diminish the accessibility to the individual borrower-members. Controlling the cost of delivery of credit continues to be an issue, it is a viable issue, but if the System is inaccessible to borrowers, it will be of no value.

The eighth component, legislation dealing with farm credit must be debated and kept separate from the farm program issue. Financial assistance necessary for the Farm Credit System should not come at the expense of current farm programs.

Number nine, we support reconsideration of lending limits and criteria for loans. We do not want to have to deal again with the same problems 5 or 10 years from now.

Number 10 of our 12 points, we support retention of current law providing for the sunset of the Capital Corporation's authority to authorize additional financial assistance after 1990. We see the Capital Corporation as a temporary workout institution, rather than as the genesis of a national bank holding company.

Number 11, we support the creation of a secondary mortgage market for first mortgage real estate loans to increase the availability of long-term credit. We support the secondary market being established within the Farm Credit System. But an important point, an oversight board should consist of equal representation from the banking industry, the insurance industry, the Farm Credit System, and production agriculture. It has been suggested two, two, two, and two. We think it should not be overbalanced toward the Farm Credit System, for example.

Our last point, and it is one that you and Senator McClure made: The Farm Credit Administration serves a vital role. It should be a true arm's-length regulator and not involved in any System policy decisions. As the System works through its problems, regulatory oversight will be of extreme importance.

Mr. Chairman, that is what we suggest and we appreciate being asked to testify here. Thank you.

Senator **Boren**. I again want to commend you and your organization for taking the time and making an effort to come forward, not only defining for us the problem but offering some constructive solutions. It is always more difficult to come up with the solutions than it is to analyze the problem and I think the suggestions you bring to us are excellent and have much merit.

I gather you feel, from listening to your statement, that we need to aim an assistance package at providing general relief to farmer-borrowers as well and making sure that we do provide some sort of an even-handed relief for all borrowers, depending upon whether they are in the System or outside.

Mr. **Kleckner**. Yes, sir. Our committee focused mainly on the Farm Credit System and those borrowers, but there is no question, there are lots of borrowers out there that are not Farm Credit System, not involved with it, and—I have a feeling, though, that the commercial banking system in this country has done a better job up until now of restructuring and lowering interest rates. We have heard about the St. Paul District and Mr. Biegler, who I think is a leader and has done the outstanding job to date. Other ones are coming, though.

Senator **Boren**. I think they are going to come. We certainly need to follow that lead on restructuring and we heard about Spokane and we need to follow that lead in Wichita as well, where I have some experience.

You talk about the need to guarantee the member-borrower stock in order to avoid the flight out of the System of the higher quality borrowers. In your mind, does that need to be a permanent guarantee, or could a temporary guarantee until such time as the System gets back into solid shape again, be adequate?

I certainly agree with you that under the current conditions we have to find a way to provide a guarantee to stop borrower flight.

On the other hand, you have talked about maintaining local control, full disclosure to the local members, no more mergers unless there is a vote of the local membership, and so on. How do we keep local control and the assurance that the members will render the System appropriately, if we give them that control, which I think we should, if they do not have some ultimate financial stake in it? That has always been the concept in the past. They were stockholders, they had a stake in it and therefore they should have the right to maintain local control. Do you have any thoughts about that?

Mr. **Kleckner**. Yes, I do. I agree with what you are saying. There has to be some local responsibility for local control. It would seem to me that the ideal, of course, ought to be only guaranteeing this stock value on a temporary basis.

Long-term decisions have to be made. The business decisions have to be made, so that that stock value is at risk, long-term.

Senator **Boren**. Long-term.

Mr. **Kleckner**. But right now, with the borrower flight, that is the reason for some of the borrower flight, not all of it, is the substantial stock value and $5,000, $10,000 or $20,000 stock down the tubes, I had better get out while I can.

It seems to me, Senator, that this would be a way that the Government could do something that likely would have no cost at all but would be of great help and great assistance.

Senator BOREN. We might be able to do it for a period of time or something, and then make sure that we maintain the concept of local control by giving people a stake in the System.

You mention the problems of the past. We realize you cannot come in and exact some reforms in a precipitous way, because we have a shortage of available credit in the agricultural sector, we have too much land being forced out of the market, and so on, but do you think we should gradually phase down lending limits perhaps over a period of time, moving back into the kind of restraints that the System operated under prior to 1971 when we raised the limits, when we took the agricultural use value off in terms of appraisals and we also, of course, went to average interest rates—in other words, we artificially made too much credit available, obviously the Government helped cause this problem. Would you say that we should perhaps phase in some gradual changes to move us in a more conservative direction for the future?

Mr. KLECKNER. I would think so. Monday morning quarterbacks do not lose games and we can look back now and see some of those mistakes that were made. They were popular at the time. As a farmer-borrower, I really liked what was being done, but in the long term it was not good for me or any other borrower, for the System or for anyone. You needed to move gradually but, you know, it was 85 percent of the value, obviously values that turned out to be very inflated and we should have known at the time, but that is just too high.

Senator BOREN. I thank you very much. There are other questions that I could go into, but since we are running behind I will not at this time. Let me assure you that these are very constructive suggestions which you have made and made on behalf of your organization and will seriously be considered by the subcommittee and it is very helpful to us as we work on this legislation.

Mr. KLECKNER. Thank you, Mr. Chairman.

Senator BOREN. Thank you very much.

We will now ask Cecil Huff, representing the National Save the Family Farm Coalition, if he would speak at this time. Mr. Huff, I apologize that we are constrained and ask you just to go ahead and make the points that you would like to make at this time.

STATEMENT OF CECIL HUFF, COCHAIRMAN, FARMERS FAIR CREDIT COMMITTEE, NATIONAL SAVE THE FAMILY FARM COALITION

Mr. HUFF. I will try.

Mr. Chairman, my name is Cecil Huff and I am a dairy farmer from Ava, Missouri. I am a co-chairman of the Farmers Fair Credit Committee, a committee of the National Save the Family Farm Coalition. The coalition is made up of more than 38 farm, rural, and church membership organizations in 25 States.

I thank you for this opportunity to address the subcommittee on solutions to the problems addressing the Farm Credit System.

You are to be commended for your eagerness to move quickly on the farm credit front, but I am here today to bring messages from the countryside that the hundreds and thousands of family farmers and rural residents bearing the brunt of the crisis within the Farm Credit System. The message is this:

The Farm Credit System is in trouble because its borrowers are in trouble. Any plan that attempts to rescue the System without directly addressing the problems of its member-borrowers will be a failed and unjust policy. The System will be on the path to recovery only when an alternative to the record number of foreclosures, liquidations, and bankruptcies is found and member-borrowers of the Farm Credit System regain the ability to fully service their loans. What is really needed here is a comprehensive plan to deal with the debt crisis, one that strengthens the System through its farmer borrowers.

Over the last year, a national committee of family farm leaders and credit experts have worked hard to develop such a comprehensive program to stop the debt crisis dead in its tracks for many of our farmers and for agricultural lenders. Our debt restructuring approach is called the Fair Credit Plan, and it is embodied in S. 658, the Family Farm Act, introduced by Senator Harkin and Congressman Richard Gephardt.

The centerpiece of our comprehensive debt relief plan is State-administered mediation programs. Mediation is a working, viable alternative to lenders foreclosing on farms that have deteriorated in value, and to families losing their farms.

Mediation provides a neutral setting that brings together a borrower and all his creditors to reestablish communication, assess alternatives to foreclosure and bankruptcy, and facilitate agreements. It is the best and least costly alternative to resolving the farm debt crisis.

Our proposal builds on the highly successful experiences of State-run right to mediation programs working in Minnesota and Iowa—several States are using voluntary mediation and several State legislatures are currently considering a program in their States. Both States have made their program mandatory, which simply assures a right to mediation for a borrower before foreclosure to explore alternatives to the farmer losing his land and the lender taking a huge loss by foreclosing.

Mediation has produced amicable, serious negotiations. Frequently, settlements have been reached. I would like to submit for the record some material that will explain Minnesota's and Iowa's programs and evaluate their effectiveness.[1]

Unfortunately, there is only so much a State can do alone. Lack of efficient resources and legislative jurisdiction have limited their effectiveness. There is an essential role the Federal Government must play. Three major problems have been encountered on the State level.

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[1] See p. 175 for the material furnished by Mr. Huff.

First, in many cases during mediation when a farmer's lenders are willing to write off his debt significantly, there still remains a substantial gap between the written-down debt payments and what the farmer can afford to pay. Second, the Farm Credit System and FmHA have not participated or negotiated seriously in many cases. Third, States have been struggling to find the necessary resources to assure their programs run properly.

The Federal fair credit plan would respond directly to these problems encountered on the State level. First, the program would provide Federal emergency debt-restructuring loans to a farmer if he still cannot fully service his loan after a lender has written down some of the debt in mediation.

These loans are designed to fill that gap between what a lender can afford to write down and what a farmer can afford to pay.

Senator **Boren**. It would be very much like a rate reduction plan, an interest rate buy-down, where you either reduce the principle or reduce the interest rate through a subsidized Federal program. Is that it?

Mr. **Huff**. Under the Harkin-Gephardt bill, it requires a write-down of principle and interest.

Senator **Boren**. Yes.

Mr. **Huff**. What we found out, and I think if you will refer to the FAPRI report, you will find out that there is a substantial number of farmers that will not survive even with an interest write-down and a principle write-down, due to low commodity prices and falling asset values, and so we need the Federal loan from the Government which would be repaid to fill that gap, and I see that as a hole in the program that you had proposed, that there would be approximately 120,000 farmers that would fall through that hole. In light of the half million farmers we have lost since the administration has taken office, we cannot afford another 120,000.

Senator **Boren**. I hate to interrupt your thought in your statement here, but do you have any idea what the amount of total loans would have to be, do you have any idea what the potential or financial exposure to the Government would be under that?

Mr. **Huff**. That figure was figured at 120,000 borrowers at an average of $20,000.

Senator **Boren**. An average of $20,000 times 120,000.

Mr. **Huff**. Yes. The legislative limit is $30,000. I think we would be talking in the neighborhood of $2 to $3 billion, which is going to be lost from the System either way.

Senator **Boren**. Loan guarantees over and above the cost of whatever it would be for the write-down?

Mr. **Huff**. This would be a direct loan and the cost to the Government would be the lost interest. The loans are repaid.

These loans are designed to fill that gap between what the lender can afford to write down and what the farmer can afford to pay. Second, the bill specifically instructs the Farm Credit System, as well as the other Federal lenders—FmHA, SBA and FDIC—to participate in mediation and negotiate in good faith. Third, the legislation provides matching grants to States to help them administer their mediation programs.

Our proposal addresses the severe problems of the Farm Credit System at the source. Right now, the Farm Credit System continues to foreclose on its borrowers in trouble in frightening numbers. In many cases, the Farm Credit System is foreclosing and taking huge losses in a rush to be rid of its "problem" borrowers.

When they foreclose, they receive much less than the market value, sometimes up to 50 percent less, due to the legal costs of foreclosing, taxes and insurance costs on the land, lost interest payments on the land, and a continued devaluation of farm real estate. Any plan to deal with the Farm Credit System must stop these losses by requiring mediation and restructuring which would insure the Farm Credit System gets at least the market value on their loans.

Another result of this rush to foreclose is that land inventories are growing rapidly. The Farm Credit System and FmHA now have over 3.5 million acres, more than the area of the State of Connecticut, in inventory. This, combined with similar increases in agricultural bank inventories, will cause further declines in land values as lenders scramble to put all this land on the market.

The fair credit plan will keep the FCS's borrowers on the land, making their payments. The huge losses incurred by the System by foreclosing will be stopped, and land prices will begin to stabilize as land stays in the hands of farmers.

In a debt-restructuring agreement under our plan, the Farm Credit System would not write off anything more than what they would lose if they were to foreclose on the farmer. In return, Farm Credit System and other lenders can "amortize" their write-offs of debt over a 10-year period, instead of taking one big loss if they were to foreclose. Also, with a successful debt restructuring agreement, lenders will keep their borrowers on the farm, with a chance of being economically viable customers again.

Some other items that I do not have in the written report but have become known to me, that we need the Farm Credit System and FmHA to guarantee credit to Chapter 12 farmers who have an approved plan under Chapter 12. It is my understanding that if a farmer gets in a plan approved for Chapter 12, if he cannot obtain the credit he is then kicked out of Chapter 12 into Chapter 7. And after you have gone through Chapter 12 and the lenders have taken a substantial write-down, they are not real eager to come back and make an additional loan and we need instructions in legislative form to Federal lenders to fill that gap.

Another item of great concern to me is the amount of inventory property. It seems to me that if we are going to rebuild our family farm structure of agriculture, we must seize upon this opportunity of in excess of 3 million acres of farm land and require that Federal lenders give priority to family farmers for reentering, to take possession of that inventory property.

Senator BOREN. Would you do that through a purchase or would you do that through a long-term lease with a purchase option?

Mr. HUFF. I think either one would be acceptable. The main thing is for the family farmer to have a contractual title to that property.

Senator BOREN. With preference to be shown.

Mr. HUFF. Yes.

In closing, I must say that there are two sides to the crisis facing the Farm Credit System. By shoring up the System without finding ways to restructure and stabilize the debts of its borrowers, you would be writing off thousands of family farmers who will continue to be foreclosed on, and further erode the Farm Credit System.

Senator BOREN. Thank you very much, Mr. Huff. I really appreciate the comments you have made, and you have had some very interesting suggestions.

On the mediation system, now, as I understand it, in Minnesota and Iowa, is that where it is now?

Mr. HUFF. Yes, they are the two most successful.

Senator BOREN. Is that a mandatory system there now?

Mr. HUFF. It is mandatory in that the lender must participate in the first——

Senator BOREN. In the first round?

Mr. HUFF [continuing]. Mediation session. There is nothing mandatory saying they must come to agreement, but it does say that they must negotiate——

Senator BOREN. Go through the mediation process, before moving to foreclosure, for example.

Mr. HUFF. That is correct, they must negotiate in good faith.

Senator BOREN. And has that been challenged in court? Has it stood muster, or do you know?

Mr. HUFF. The Farm Credit System is challenging it.

Senator BOREN. It is challenging it.

Mr. HUFF. Yes.

Senator BOREN. But there has not been an expressed court ruling yet on this point?

Mr. HUFF. Not to my knowledge.

Senator BOREN. We will receive for the record the information you brought with you about how the System is working.

Do you know offhand how many, what percentage of the mediations, if all of them go through this first mandatory round of mediation in those States, what percentage of those end up reaching some sort of an agreement? Do you have any idea?

Mr. HUFF. Off the top of my head, I think the valuation of them will show 2,600 cases the first 6 months, 750 of them reaching mediation agreements.

Senator BOREN. Quite a substantial number that have reached agreement.

Mr. HUFF. And I think back to the previous testimony, before Mr. Kleckner, in regard to the Minneapolis-St. Paul Farm Credit System——

Senator BOREN. Yes.

Mr. HUFF [continuing]. I think the impetus for calling borrowers in was because of the mediation law in that State.

Senator BOREN. That really helped get the ball rolling there in that area——

Mr. HUFF. Yes.

Senator BOREN [continuing]. In terms of getting restructuring going.

Mr. HUFF. Yes.

Senator BOREN. Well, I appreciate your testimony very much and we will put it fully into the record and also any other material that you would like to submit with your statement.

Mr. **Huff**. Yes, I have some material from Jim Matthews, an attorney in Minnesota, with the Farmers Legal Rights group, which addresses some specific problems in the Farm Credit System which I would like to make available to you and your members.

Senator **Boren**. We would be glad to receive that for the record. We thank you for your testimony and for your patience. I hope we have not caused you to miss your transportation arrangements.

Mr. **Huff**. I appreciate you allowing me to come up.

Senator **Boren**. Thank you very much.

[The following material was furnished by Cecil Huff in support of his oral testimony:]

[Reprint from the Minneapolis Star and Tribune, Dec. 5, 1986]

LOAN MEDIATION PRAISED BY MOST—EXCEPT LENDERS

(By Susan E. Peterson, staff writer)

Nearly 3,000 Minnesota farmers participated in the state's mandatory mediation program during its first eight months, and a survey showed that a large majority of all involved parties—except lenders—felt that it was a success.

The program, which requires lenders to participate in mediation before filing a foreclosure suit on an agriculture-related debt, is the first of its kind in the country. It is being used as a model by other states and the federal government. Other countries also have expressed interest.

The University of Minnesota Extension Service, which administers the program, reported by farmers, 673 cases reached mediated settlements and another 488 were settled outside the process after a mediation request was filed.

However, 64 percent of the surveyed lenders called for terminating the program.

The Extension Service conducted the survey of 726 farmers, lenders, mediators and extension agents as part of an assessment of the program. It concluded that the program succeeded in its fulfilling its mandate, which was to bring farm debtors and creditors together in an orderly process to discuss debt restructuring options.

Kathy Mangum, who heads the mediation program for the Extension Service, said the law requiring mediation was characterized by politicians "as a way to save the family farm," but noted that lenders were required only to participate in mediation, not to restructure farm debts.

However, the service concluded that some changes in the program are necessary, particularly in the level of funding.

Patrick Borich, dean of the Extension Service, said it has spent $568,000 to date and estimated that a total of $1.7 million will be spent by June 1987. The Legislature allocated only $360,000 for the program.

Attorney General Hubert Humphrey III praised results of the mediation program and said the Legislature will be asked to provide adequate funding through June 1988. Borich said at least another $1.7 million will be needed to cover the program from June 1987 until June 1988.

A detailed analysis of mediation outcomes is not available because of shortcomings in the Extension Service's record-keeping methods. The program was set up within days of the law's passage in late March, and extension officials said most of its efforts went into setting up and running the program rather than gathering data on mediation results.

The survey showed that farmers were better prepared for making tough decisions about their future as a result of the program, said extension analyst Dick Krueger, and that communications between farmers and lenders were greatly improved.

In addition, he said, mediation fostered "peaceful change" in rural communities and eased tensions and frustrations on the part of farmers and lenders.

Lenders, however, said that mediation is seriously affecting the availability of credit for other farmers and that many farmers were not adequately prepared for negotiation sessions. Extension officials agreed that more financial counseling should be provided to farmers before mediation sessions.

Creditors were not the only participants reporting problems with the process. Extension agents, who were responsible for implementing the programs, said they were working an average of 52 hours a week and still having to cut back drastically on regular educational efforts.

Humphrey said that the mediation process has "taught us some valuable lessons," but that some clarifications in the law are needed.

The law requires a "good-faith" effort on the part of lenders and farmers to reach an agreement. He said a better definition of "good faith" should be addressed. Humphrey also advocated programs to make sure that people are properly prepared for mediation sessions.

FARM CREDIT MEDIATION

EVALUATION SUMMARY

People will say nothing happened, but they forget the process is very important. It makes for honest dealings between people involved. The situation is not very nice for anyone. Everyone is taking a loss, and we all want to take as little as possible. So we need level-headed people to help in the negotiation process.—(Farmer in mediation)

PROGRAM LEGISLATION

In March 1986, the Minnesota Legislature enacted a Farm Bill that authorized the Minnesota Extension Service to set up and administer the Farm Credit Mediation Program. The legislature was concerned about the increasing number of Minnesota farmers facing severe financial difficulties and the strained relationships between borrowers (farmers) and lenders. The purpose of mediation is to provide an orderly process to adjust farm indebtedness.

EVALUATION COMMISSION

This evaluation of the Farm Credit Mediation Program (FCMP) was commissioned by the Director of Extension to determine how well the program worked and to provide information for decision makers to use to determine the future of the program.

FINDINGS

1. The program was successful in three ways.

First, farmers are more prepared for change and are making adjustments. Settlements were successfully reached which required compromise on the part of both farmers and creditors.

Second, improved farmer-lender communication resulted from mediation. The communication channels established in mediation provide for open discussion of strategies and improved understanding of farmer/lender positions for all parties.

Third, diffused tension. The program fostered peaceful change within communities. Frustration and tension were minimized due to mediation which provided a constructive process for resolving farm indebtness.

The program was rated highly by those most effected by it and participation in the program exceeded expectations.

Approximately 2,600 cases were handled in the first 6 months and about 750 cases reached settlement.

2. The program should continue, according to all parties except creditors.

Should the Farm Credit Mediation Program continue?

Group:	*Percent*
Farmers in mediation	85
Mediators	76
Agents	65
Farmers not in mediation	60
Creditors	15

All parties in mediation suggested changes in the legislation. Suggested changes focused on the time span of mediation and clarification of ambiguous aspects of the law.

During the past 90 days I have sensed a growing awareness of the need to settle differences and get on with business and life. It may be that mediators imparted this attitude. If so, then mediation has already served its purpose.—(Lender)

MANDATORY FARM CREDIT MEDIATION: WHAT IT IS AND HOW IT WORKS

(By Joyce Walker, Extension Specialist, Minnesota Extension Service)

In Article I of the 1986 Omnibus Farm Bill, the Minnesota Legislature voiced support for mediation as one means of orderly process to assist farmers and agricultural lenders address issues of agricultural indebtedness. The effective date of Article I was March 22, 1986. While the use of neutral mediators in voluntary mediation meetings is encouraged, the law also instituted a program of mandatory farm credit mediation. It is important for farmers and lenders to understand what mandatory mediation is and how it is being implemented in Minnesota.

MEDIATION: THE PROCESS

Mediation introduces a neutral third party into borrower and lender discussions in order to facilitate discussion and generate alternative plans. All decisions and recommendations are made by the debtors and creditors. Farmers and lenders come to mediation with the understanding that they will seek a mutually agreeable solution that, in the best way possible, meets the needs of all parties.

Key elements of the process are:

It focuses on constructive outcomes.

It assures an equal voice for all parties.

It allows people to determine the results and develop creative solutions to difficult problems.

It allows for a case by case consideration of problems and focuses on solutions that meet the needs of debtors and creditors in each specific instance.

The Minnesota Extension Service has the responsibility of developing and administering the Farm Credit Mediation Program. This folder describes the way the program operates and answers some common questions about mandatory farm mediation.

MANDATORY FARM CREDIT MEDIATION

The use of the word "mandatory" in this situation does not change the mediation process for problem-solving. "Mandatory" means that no creditor can start a proceeding to collect a debt against agricultural property until the creditor and debtor have first attempted to reach resolution of the issue thorugh mediation. Creditor is defined as persons or organizations holding secured debts of more than $5,000 against agricultural property. This includes mortgages, liens or security interests, judgments and contracts for deed. The mandatory program imposes some timelines, requires good faith participation, and stipulates that settlements agreed upon by all parties are binding legal contracts.

Mandatory farm credit mediation is a last resort action to be employed when all other attempts to resolve disputed issues of farm credit have been exhausted by the borrower and the lenders. Hopefully very few contractual disputes between borrower and lender will ever reach the stage of mandatory mediation. The Mandatory Farm Credit Mediation Program should be used only if discussions between parties have broken down and adverse legal actions for debt collections are necessary and impending. It is not intended to replace the serious good faith bargaining and discussion inherent in debtor/creditor relationships.

HOW THE MANDATORY MEDIATION PROCESS WORKS

A creditor with a secured debt of more than $5,000 against agricultural property must initiate mandatory mediation before proceeding with foreclosure, repossession, cancellation of contract or collection of a judgment. To begin mandatory mediation, the creditor must "serve" a Mandatory Mediation Notice with the debtor and with the County Office of the Minnesota Extension Service. This Notice must be sent by certified mail or personal delivery and requires a signed receipt.

A debtor receiving a Mandatory Mediation Notice has two choices: 1) to do nothing and allow the creditor to move ahead, or 2) to file a Mandatory Mediation Request with the County Extension Office within 14 days indicating a desire to enter into mediation as an attempt to resolve the issues. The Request forms are available at the offices of the County Recorder and the Minnesota Extension Service in each county. The names and addresses of all known secured creditors must be included on the Request forms.

The Minnesota Extension Service coordinates the program and provides farm financial analysis assistance. If a debtor does not respond to the Mandatory Mediation Notice within 14 days, the County Office informs the creditor that mediation is waived and proceedings against agricultural property may begin. If the debtor does request mediation, the County Office initiates several actions:

1. Assigns a credit analyst to the debtor.
2. Provides names of farm advocates to the debtor.
3. Sends a Mediation Meeting Notice to the farmer and all specified creditors.
4. Sends creditors and debtors the names of 3 volunteer mediators available to work on the case.

Both the debtor and the creditor have the right to remove one name from the list of 3 mediators. To do this, a letter must be sent to the County Extension Office within 3 days of receipt of the Mediation Meeting Notice. While the goal is to appoint a mediator acceptable to all parties, the MN Extension Service has the final decision in appointing a mediator under the guidelines established in the law.

Mediation takes place over a 60-day period. All known creditors with secured debt of more than $5,000 with interests in real estate and farm operations are invited to participate. The debtor works with the assigned credit analyst to prepare records and financial information. Negotiations begin, and alternative strategies are formulated with the help of the mediator who schedules meetings and guides the discussion.

Time is spent clarifying the issues and discussing options for settlement. Pertinent facts and information are surfaced. Expert advice may be requested and discussed. The mediator takes the lead role to stimulate cooperation, help define the issues, emphasize common goals, assure that all parties have a chance to speak, keep the discussion focused, and reduce guilt or blame-placing. Creative ways to solve the problem are encouraged from all parties.

When all parties have reached agreement, the settlement is written, and copies are provided to each person. The parties should have the tentative agreement reviewed by attorneys, supervisors, outside experts or family members. When all parties are satisfied that the agreement represents a realistic settlement, the agreement is signed and becomes a binding contract. Parties are responsible for carrying through with paperwork and contract changes necessary to implement the new agreement.

OBLIGATIONS OF THE PARTIES IN MANDATORY MEDIATION

All parties who agree to participate are required to attend mediation meetings on a regular and continuing basis. They must provide full information about the financial obligations at issue. And they must participate in generating realistic alternative plans for debt restructuring with a willingness to negotiate a settlement.

The debtor is required to supply the financial records necessary to resolve the issues of agricultural debt which are the subject of the mediation. The assigned credit analyst can assist in this. The debtor must identify all known creditors with whom there is secured debt of more than $5,000 against agricultural property.

The creditors must be represented in mediation by a person with the full authority to negotiate and make binding commitments. They must make provision for release of funds from the sale of farm products so that the debtor has necessary living and farm operating expenses during mediation.

Failure to meet any of these obligations may result in a lack of good faith judgment. A failure to agree to reduce debt, restructure, refinance, or forgive debt does not, in itself, show a lack of good faith by a creditor.

THE ROLE OF THE MEDIATOR

The mediator leads and manages the discussion as a neutral without making decisions or judgments. The mediator's job is to ensure that all participants in a mediation get to speak and be heard, help define the issues, emphasize common goals, keep discussion focused, facilitate discussion of all options and assistance programs, and reduce fault finding. During the mediation session, the mediator is responsible for keeping things orderly, fair, and moving forward.

The mediator may advise, counsel and assist the parties on ways to come to agreement, but does not tell the parties how they should conduct their business or personal affairs. Under no conditions does the mediator advise on legal matters or advise/assist parties in determining their legal rights.

Mediators are immune from civil liabilities for actions as mediators. They cannot be examined about a communication of document made or used in the course of mediation.

If the mediator determines that one of the parties is not participating in good faith as defined in the law, an affidavit is filed stating the reasons for the finding.

The debtor and creditors receive copies of the affidavit, and the mediation is terminated. Mandatory court supervised mediation may result.

QUESTIONS ABOUT MANDATORY FARM MEDIATION

Who is involved in a mediation session?

At the minimum, the debtor, secured creditors of agricultural property, and the mediator are present. Family members can be included.

The presence of support people at a mediation must be agreed upon by the parties. The mediator will determine the level of actual involvement of these support people in the mediation. In no case shall a third party speak on behalf of a primary participant. People who agree to mediate speak for themselves, but can consult with other experts during the process.

Must all known creditors attend the mediation sessions?

All known creditors with a secured debt of more than $5,000 are asked to participate in mediation. They have three choices. They may participate to negotiate their interests in the issues. They can choose not to participate and become bound by the terms of the settlement reached. Or they can file a claim form with the mediator prior to the mediation. This claim form gives them the right to object to the settlement agreement reached in their absence within ten days of notification of the settlement. If such an objection is filed, the mediator calls all parties back for further negotiations within 10 days.

Are there guidelines for disclosure of information?

Parties are expected to enter into mediation with full commitment to work toward constructive resolution of the issues. Honesty and full disclosure are basic ingredients for a complete discussion and an honorable agreement.

The Minnesota Statute covering civil mediations stipulates that mediation proceedings are confidential and may not be used as evidence in a court of law at a later date (unless there is clear evidence of intention to defraud, of corruption, or misconduct).

How binding is the result?

The settlement agreement reached in mandatory mediation becomes a binding contract which may be used as a defense against an action contrary to the mediation agreement. The Memorandum of Settlement is prepared by the mediator, reviewed by all parties, and reviewed by attorneys or other experts if desired. When all parties agree that the Memorandum of Settlement reflects their understanding of the agreement it is signed.

What if the mediation fails to generate resolution?

If all parties work in good faith during mediation and no agreement can be reached, the mediation is at impasse and is terminated. Creditors may proceed to enforce the obligations of past contracts.

What is court supervised mandatory mediation?

If the mediator finds that a creditor has not participated in good faith mediation, the debtor may file an affidavit with the district court of the county where property is located. The court will appoint a mediator for court supervised mediation. The court shall then require the parties to mediate for no more than 60 days under court supervision. If lack of good faith continues, an additional 180 days suspension of creditor remedies may be ordered.

Where does the mediation take place?

The parties involved agree upon a neutral location in the community. The home or office of a participant is not appropriate. Libraries, churches, schools or public buildings are often used.

When are mediations scheduled?

Mediations are scheduled at the convenience of the Volunteer Mediator and the parties.

What if adverse proceedings are begun without Notice of Mandatory Mediation by the creditor?

If adverse action is begun involving a debtor who has not received a Mandatory Mediation Notice, the debtor can file a Request for Mediation with the Minnesota Extension Service county office. The request form must indicate that the debtor has not received a Mandatory Mediation Notice.

Where are forms necessary for Mandatory Mediation obtained?

Forms are available at the County Recorder's office and the County Office of the Minnesota Extension Service.

Senator **Boren**. I am going to turn now to the Attorney General of the State of Oklahoma, Robert Henry, who will be our next witness.

Governor Henry Bellmon, who was a previous Member of the Senate and former member of the Senate Agriculture Committee, had planned to be here today and, having once been the Governor of Oklahoma myself, I understand when the legislature is in session why the Governor felt it would be unsafe for him to leave the State at this particular period of time. He has been giving a good amount of counsel to us.

Let me say that symbolic of the bipartisan approach that we have to agricultural problems in our State, that our Republican Governor has sent the Democratic Attorney General who will speak for him today. He is an outstanding public official in our State, and I say this about the attorney general with complete objectivity, having been the chairman of his campaign committee this last year. [Laughter.]

So we are very glad to have you this morning, Mr. Henry. As I understand it, you are going to present the statement of Governor Bellmon to us at this time.

STATEMENT OF HON. ROBERT HENRY, ATTORNEY GENERAL, STATE OF OKLAHOMA, ON BEHALF OF GOVERNOR HENRY BELLMON

Mr. **Henry**. Thank you, Mr. Chairman. I will try to summarize part of that. The statement has been copied and we request, if you approve, making it part of the record.

Senator **Boren**. We will enter it in full.[1]

Mr. **Henry**. I do not bring the expertise, of course, that Governor Bellmon brings, having been a Member of this body for two terms and being a farmer himself, but we often work together on important things and I told him if he would take the three-syllable words out of his statement I would read it for him. He responded that he does not use three-syllable words anyway. [Laughter.]

So let me just briefly present the proposal that the Governor offers. Mr. Chairman, let me track for you what frequently happens, as you know, in farm credit problems. A farmer finds it impossible to service his debt to the Federal land bank. The Federal land bank then either takes a title to the farm in lieu of foreclosure or in some cases proceeds through the courts to foreclose on the land. The land is then turned over to the Capital Corporation or is auctioned off.

If the land is auctioned, normally the price received will be well below the face amount of the loan, causing the Federal land bank to take an immediate and serious loss.

Frequently, the new buyer will be given a preferential interest rate by the Federal land bank and since the purchase cost is low, the new buyer has a chance of handling the debt service.

There are, however, three unfortunate results of the above policy:

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[1] See p. 417 for the prepared statement of Governor Bellmon.

1. A farm family has been put out of a livelihood and out of a home, and in many cases will need social services, including welfare. In addition, a rural community is further depopulated;

2. The Federal land bank has taken a serious loss on its balance sheet; and

3. The local commercial bank which held the operating loan now owns a set of farm machinery which has little value.

The Governor proposes a solution to that problem. Quoting again, here is what I believe should be done:

The Federal land bank should be allowed to make "debt for equity swaps" and take an undivided ownership in the land in cases where farmers or ranchers find it impossible to handle their debt service. The amount of the ownership could vary up to 90 percent, if need be, leaving the present owner in possession of a share of the ownership but in a position to continue living on the property and managing the land as part owner/part tenant.

The farmer would continue to pay interest on the amount of ownership retained and would pay the Federal land bank cash rent on the portion owned by the bank. The cash rent would be figured at Treasury costs of money on the face value of the loan.

The farmer would be given an option to repurchase during the time period between 5 and 10 years out. At the expiration of the 10-year period or at a time mutually agreed to prior to that, the land could be sold and the profits distributed according to the agreement. The Federal land bank would accrue charges against its share of land at the rate reflecting Federal land bank costs of funds. This amount would be recovered when the land was sold or when the present owner repurchased the Federal land bank interest.

The Governor has attached a series of tables indicating how this might be done.

I would like to review briefly the benefits and make one other summary of his statement:

The benefits of this approach are many:

1. It would leave the farm family on the land and avoid the social consequences of another major rural migration into our cities;

2. It would prevent the Federal land bank from taking sudden large losses on its balance sheet and it would avoid the necessity of a multi-billion-dollar bailout by the U.S. Treasury;

3. It would provide lower annual land costs to farmers, giving them a chance to survive until the farm economy improves;

4. The commercial banks which, in many cases, have made operating loans to farmers would avoid the necessity of liquidating farm equipment and the loss which that entails; and

5. The rapid decline in farm land values due in part to excessive sales of foreclosed lands would be slowed or halted.

As you know, Mr. Chairman, when we speak of this in Oklahoma, we speak from experience. Forty-nine banks have failed in our State; 11 banks have failed since January 1, almost one per week.

In addition, the Governor proposes one other proposal in his testimony. I hope that members of the committee and people attending this hearing will have time to read the statement because I think it is very, very good. I can say that about my client, I guess.

He also, in the last part of his statement, suggests another proposal, and I would like to read that briefly:

Mr. Chairman, I believe the time has come for the United States to lead the way in the establishment of an international grain agreement. The objective would be to achieve participation by other grain exporting nations in multilateral restraints on grain production until supply and demand are more nearly balanced. The cost is too great for the United States agribusiness and the U.S. Treasury to shoulder alone.

At the present time, many countries, including the United States, are offering export subsidies which have the effect of reducing grain prices even further. This is helping to impoverish food producers worldwide. Impoverished farmers cannot afford the inputs necessary to sustain production or to protect their land. Neither can they afford to purchase factory outputs or educate their families.

Mr. Chairman, this hearing is basically about the problems with the Farm Credit System, but its problems cannot be dealt with in isolation. In striving for a solution, I strongly urge the subcommittee to look at the overall problems of agriculture and seek to provide not only credit but a stable and fair price structure, a structure that will allow a decent standard of living in the rural areas of the world and assure that farm families have the resources needed to care for their families, protect their soil and continue to provide the abundance of food and fiber which the world has long taken for granted.

Thank you.

Senator **Boren**. Thank you very much, Mr. Henry, and thank Governor Bellmon for his statement. We have discussed the last item several times before, he and I have discussed that in terms of trying to get multilateral participation. I could not agree with him more. We have tried to share all of the burdens ourselves here in this country for a long time and we simply, the taxpayers, the infrastructure, and the farmers simply can no longer afford to do that by ourselves. I hope that we can, while we have been frustrated because Presidents of both parties have never put that matter high enough on the agenda, to really raise it to the level of a head of State, which is what has to be done to get these kinds of multilateral negotiations going.

The Secretary of Agriculture cannot do that. It takes the President of the United States to do that and, frankly, we have not had Presidents, either Democratic or Republican, who have been willing to put agriculture high enough on the agenda to get those kinds of negotiations going, but I hope we will see that.

On the restructuring and the situation where the farmer would be allowed to stay on the land, do you know if the Governor has any concept of making sure that the repurchase agreement, when the farmer would repurchase the full ownership of the land, whether or not that would be of agricultural value?

Mr. **Henry**. I think that he would optimistically like to see that. I do not think that this proposal has that in place, because he knows of the tremendous costs and problems that Congress entails. I think the concept of giving Oklahoma farmers more time is something that he thinks is almost the bare minimum.

Senator **Boren**. Right. Let me ask you—and I do not know if you could answer this for him or if you have discussed this with him, if not maybe you could ask him—whether or not he would feel that perhaps some of the same benefits might be provided that you would get from a long term, in other words, the Government owning part of the land, the title so to speak, with the farmer having the option to rebuy it. Instead of going through the program exactly like this, if you could set up a long-term lease of the land that the farmer is now farming from the Government at a reasonable rate to allow that farmer to more than break even during this period of time, with again an option to purchase the land back at its agricultural value at the end of it, whether or not he would feel that that kind of mechanism might have approximately the same impact.

Mr. **Henry**. I think he would favor that approach. In his statement, he talks about the necessity for an element of "pain" being involved, and I do not think that should be taken out of context. I think he wants to make sure that any system that is structured is one that is fair and is not abused by people who can in fact handle the debt.

Senator **Boren**. Right. So we have some mechanism showing that these are people who can operate efficiently——

Mr. **Henry**. Correct.

Senator **Boren** [continuing]. Take care of the land appropriately, that would have an opportunity to stay there on the land they are now farming and to eventually get full title to it back through a reasonable mechanism.

Mr. **Henry**. Who have shown the ability to do so.

Senator **Boren**. Right. Well, I really appreciate your appearing and thank Governor Bellmon again for sending the testimony.

Mr. **Henry**. Thank you very much, Mr. Chairman.

Senator **Boren**. And for you very ably presenting it to us today. Next I am going to ask—what we will do is have Mr. Beesley come forward next, the Chief Executive Officer of the Farm Credit Corporation of America, and then when Mr. Beesley finishes we will then go right into our panel of Mr. Hankes, Professor Harl, and Mr. Dahl, and we will proceed right with that panel and try to get us completed here within a reasonable period of time. We will be coming back in the afternoon session at 2:00 o'clock, and I would remind you that those of you that are testifying this afternoon, if you come in and start testifying in this room, it will be the wrong place and they will look at you with some puzzlement. We will be moving upstairs to room 428A this afternoon, which is the Small Business Committee room, which is just directly above us here.

I have had experiences before sometimes when chairing hearings and people come in and give very eloquent testimony but to the wrong committee, and really it is a good test to see whether the members of the committee are paying attention to the testimony. [Laughter.]

But as they nod their heads and say thank you for your input into this question, we want to make sure that—our committee is anxious to get your testimony, so we want to make sure that you get to the right place this afternoon.

Mr. Beesley, we will have you proceed, and again I apologize for the constraints of time, but perhaps if you can hit the highlights for us as much as possible.

STATEMENT OF H. BRENT BEESLEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT CORPORATION OF AMERICA, ACCOMPANIED BY TRAVIS W. POTTER, MEMBER OF THE BOARD, FARM CREDIT BANKS OF OMAHA

Mr. **Beesley**. Thank you, Mr. Chairman. I am accompanied today by Travis Potter who is a farmer-elected director from the State of Iowa. He has a very brief comment. Would it be appropriate for him to make a brief statement?

Senator **Boren**. That would be fine.

Mr. **Beesley**. Thank you.

Mr. **Potter**. Thank you, Mr. Chairman.

My name is Travis Potter, and I am a farmer-director of the Farm Credit System of Omaha. I am a member of the executive committee of the Farm Credit Council and also a member of the council's legislative committee.

My son and I have a 1,300 acre farm near Hospers, Iowa. We raise corn and soybeans and have a farrow-to-finish hog operation. Also we feed some cattle. I was elected to the Omaha district board 3 years ago and currently serve as its vice chairman. I have been a cooperative director most of my adult life.

Our farm was homesteaded by my great-grandfather in 1876 and I have farmed this land since 1948. My son is currently the fifth generation of our family on this land.

Mr. Chairman, agriculture in my home area is still what I consider to be mostly family farms. The bulk of the labor, management and capital is supplied by the family. You are well aware of the problems that the Omaha banks have had. We were one of the first districts to experience the level of problems which have now spread to other parts of the Farm Credit System. Yes, our district has made mistakes. No one can deny that. But as directors, we believe we have taken the necessary steps to refocus the district once again toward the borrower-stockholder. If we do not meet his or her credit needs, we know we are not doing what we were elected to do.

I want to talk briefly about what we are doing in Omaha, because I think it is similar to what is happening in some other districts.

Last fall, there were major changes in bank management. This January, we hired a new CEO and bank president, Jim Kirk, a highly regarded senior executive from a commercial bank. He has brought fresh ideas and new insight into ways to solve our problems. He has been instrumental in working with our board in laying out a recovery plan for the Omaha district.

Our district is pursuing policies which we believe are in complete harmony with your ideas, Mr. Chairman, about local control.

First of all, we are recognizing our problems:

Borrower flight is a significant problem which we can address only on a very limited basis. The real answer lies in what is done in a legislative package to restore borrower confidence that their stock and allocated equities will be safe.

Nonaccrual loans and acquired properties are a major problem. Our recovery plan targets $300 million in loans for restructuring in the next 3 years: $140 million in 1987, $85 million in loans in 1988, and another $85 million in 1989. We want to keep farmers on the land. In accordance with the System's policies, our district views foreclosure as undesirable and only as a last resort. With respect to acquired properties, we are making sales at the current appraised market value. In January and February of this year, we sold $20 million in properties, mostly for cash to farmers. In March, we expect those sales to reach $25 million.

We recognize that decisions on credit are best made in the field, not in an office in Omaha. Today, our credit teams are in the field working in branch and association offices. That is a reversal for us, but we recognize that it is a necessary one. Qualified loan officers and experienced local management are in the best position to know the borrower, evaluate the local market, and react to local situations. We do not intend to miss opportunities to work with current borrowers and make new loans.

At the regional level, management and boards are going to monitor local decisions to make sure that this new process works. Understand, Mr. Chairman, that we are undertaking a major change in attitude in this effort. It again recognizes local responsibility and control.

Mr. Chairman, I am also aware that you support a federally funded interest rate buy down program directed towards those farmers who are highly leveraged and in serious financial condition. I believe that this concept has a great deal of merit.

Farmers experiencing financial difficulty cannot afford to pay competitive interest rates that are charged on high risk loans. For them to survive, their rates must be lower. In addition, as a cooperative lending institution, we cannot afford to subsidize the rates to the level necessary for these borrowers. If there is such a program to buy down rates, we believe that cost should be paid by the Federal Government.

The testimony which Mr. Beesley is about to give represents a consensus position amongst all the districts of the Farm Credit System. We are together on the need to maintain this System as a borrower owned and controlled lending source for the benefit of U.S. agriculture today and for the future.

Thank you, Mr. Chairman.

Senator **Boren**. Thank you very much. I appreciate you being here with Mr. Beesley today as a member of the board and part of the System, and we are also glad to hear about some of the things that are beginning to occur in Omaha, too, as well.

Thank you very much.

Mr. Beesley.

Mr. **Beesley**. Mr. Chairman, I will be brief.[1] We do appreciate very much this hearing and are very anxious to hear the testimony that is presented.

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[1] See p. 426 for the prepared statement of Mr. Beesley.

As Travis mentioned, during the last 3 days the presidents and the farmer-elected directors of the 37 farm credit banks have been meeting in Denver to discuss the various legislative alternatives. The discussions were very sobering; exchanges were frank; but I am pleased to report that a strong consensus did emerge on all of the critical legislative issues facing the System.

One long-time PCA and bank director said that in all his years with the System he had never seen the Farm Credit System more united in purpose or more resolved to address the problems that it now faces.

Mr. Chairman, the participants in the Denver meeting fully support the principles of the proposals in this statement. This group of farmer-directors from all across the Nation overwhelmingly passed a resolution expressing appreciation to Congress for passage of the 1985 and 1986 amendments and urged that these laws be fully implemented.

I believe had the directors had the proposal that Senator McClure and others are currently discussing, they would have overwhelmingly supported that. It very closely resembles the major points that we had in our meeting.

As you know, Mr. Chairman, the System is in the process of generating the most comprehensive and internally consistent financial forecasts in our history. One of the purposes of this undertaking is to provide the Congress and the administration with necessary information to make informed decisions about the need for assistance and if such assistance is needed to correct decisions about the timing and amount.

We expect this project will be done in late April. When completed, we will be able to provide information to the Congress as to how much, at least in our view, each alternative that is being considered will cost. How much it will cost if we approach it this way; how much will an interest rate buy-down cost; how much will various restructuring proposals cost, et cetera, et cetera, the whole gamut with numbers to accompany it.

In Denver, the legislative committee and the directors adopted some very general goals for legislation which are outlined on page 5 of my testimony, and I will not go through that.

On page 6, we have some specific legislative proposals. We would like very much to work with the subcommittee to refine these proposals, and we would also like to work with our friends in the various groups that represent farmers, ranchers and cooperatives to refine these proposals to meet the needs of their members.

I think we have a good working relationship with several of the groups that will be testifying today, and we, as I mentioned, are anxious to hear their testimony and work to provide some numbers to support some of those positions.

I will not go through those specific proposals, Mr. Chairman. In summary, the thrust would be to try to utilize the framework established in the 1985 amendments, to see the Capital Corporation become an effective tool for System self-help and a mechanism through which financial assistance might be channeled if that is necessary.

Senator Boren. In essence, using the approach I think that Senator McClure called the clean bank approach, in other words trying to let the rest of the System in essence be——

Mr. Beesley. That is one of the tools that the Capital Corporation could do.

I think it is important to note that the System wants to be a set of well-run, well-managed institutions. To the extent that the Congress does determine that there are measures that should be taken that would otherwise jeopardize 90 percent of our borrowers who are current, who are trying to make ends meet, we believe that those programs should be for all lenders and should be funded by the Government.

Thank you, Mr. Chairman.

Senator Boren. Thank you, Mr. Beesley.

I have a few questions that I would like to ask. I do not want to replay past history, because our purpose is not to focus on the mistakes of the past but to get on with the solutions.

In August 1985, Governor Wilkinson announced that the System would need assistance. Congress acted that fall and since then we have been talking about the serious nature of the problem. Why is it that we have waited for a year and a half to begin this kind of comprehensive analysis and the gathering of data to give us an indication of exactly the amount of assistance that will be required? Why have we waited so long?

Mr. Beesley. You will recall, in 1985 the System came forward and asked for between $6 and $8 billion of assistance. Congress reacted with the 1985 amendments which created a mechanism whereby assistance would be provided upon certification by the FCA and Treasury. We have supported that process continually.

We have made financial forecasts every 6 months since that time. We presented the Congress with forecasts in October. The next regularly scheduled forecasts will be out in April. We can operate off the 1986 forecasts. They did not show clear evidence that the timing had come, and neither Treasury nor FCA had certified.

Senator Boren. Well, can you assure us—do you know exactly when in April you will have those figures ready for us?

Mr. Beesley. No. We have got a meeting scheduled currently in St. Louis of all the bank presidents to discuss and analyze those figures and that meeting is scheduled for the 27th and 28th of April. We hope that we can have some of the figures to the Congress before that date.

Senator Boren. Let me urge you, if you can, we come back into session on I believe the 20th or 21st of April, after the Easter recess, and we would very much hope that we can get under way before then. We may well try to start some workup on some principles before that period of time, but we would like to really be able to push on with the areas of legislation that would also require us having some reliable financial data to work with. So I would hope that we could, that as a target, we could set as a goal, having for our committee around the 20th or 21st when we return, have that information available to us——

Mr. Beesley. We will make that our goal, Mr. Chairman.

Senator Boren [continuing]. Because we are anxious to move ahead as quickly as we can.

Now, we asked in February, I requested the number of loans that have been restructured by having the principal written off. Do you know at this point, of the 3,741 loans that have been restructured, according to your testimony, in February, how many of them actually had principal reduced or how much of that principal on average is written off?

Mr. **Beesley**. Mr. Chairman, we responded to some written questions in that regard that should have been delivered yesterday or today. I thought I had that.

Senator **Boren**. I think there was a response but no numbers in it. Do you know if we could——

Mr. **Beesley**. Well, the responses have the numbers in them. Let us see—here it is. Mr. Chairman, you asked how many restructured loans there are systemwide. As of December 31, 1986, the System recorded 3,794 restructured loans. Restructuring had taken the form of asset transfers, granting of equity interest, reduced principal, reduced interest rate, suspended maturity dates, and combinations of the above.

Senator **Boren**. Right.

Mr. **Beesley**. You then asked how many restructured loans had reduced the total principal. As of December 31, it appears that losses recorded on these restructured loans amounted to about $119 million, out of a total principal balance of roughly $735 million.

Senator **Boren**. $119 million of principal was written off?

Mr. **Beesley**. Total losses. Now, it is not all principal. It includes reductions in legal fees, insurance and other—we do not have it categorized solely by principal, but it was the amount that was owed at the time for——

Senator **Boren**. You do not know how many of the loans involved that?

Mr. **Beesley**. How many of the $3,794,000?

Senator **Boren**. Yes.

Mr. **Beesley**. No, I do not.

Senator **Boren**. If you could, it would be interesting to me just to know what proportion of those 3,700-plus did.

In your testimony, you stated that the System supports a concurrent resolution stating Congress' commitment to protect borrowers' stock. As you know, Senator McClure, Senator Boschwitz and myself have been working on such legislation. We have been trying to circulate a sense of the Senate or sense of the Congress resolution to that point. It sometimes is easier to get a sense of the Senate resolution than it is to get a concurrent resolution.

In your view, would there be fundamentally any difference between the two, or would one work as well as the other? Do you have any opinion on that?

Mr. **Beesley**. Well, I think obviously the greater support of that type of resolution, the better, Mr. Chairman. As I mentioned, the System would strongly support the resolution that you have proposed and would hope that both Houses could act upon it.

Senator **Boren**. If we could go with one House and then get the other House, a sense of the House resolution, it might be a faster way to operate.

I understand that only two of the districts are now making long-term loans, what we mean by that, 15-year-plus loans. Of course, when the Federal land banks were created in 1916, one of the principal reasons for the creation of the System was stated to be the availability of long-term credit at reasonable rates of interest to farmers.

Why is that? Why are we not continuing this commitment to long-term loans that has existed in the past?

Mr. **Beesley**. Mr. Chairman, all of the banks make long-term loans. It is long-term, fixed-rate loans that are only being made in two districts. The other long-term loans have variable rates.

I am personally trying to encourage all of the banks to make long-term, fixed-rate loans. I think that it is a very preferable product to the borrower than a variable-rate loan, because it takes one more element of risk out of their operation. But, of course, the funding of long-term, fixed-rate loans is very dangerous, because to the extent you go out and borrow long-term, fixed-rate money and then the borrower prepays his loan, you are set with the situation that the System now faces.

This is one of the reasons why the System is actively engaged in working with our other lender friends to develop a secondary mortgage market for agricultural loans, because it would provide us a greater flexibility in making long-term, fixed-rate loans.

Senator **Boren**. If we were able to get some of these things done, including the secondary market and some of the other changes that are being contemplated here, would it be your view then that the districts should get back into the business of offering long-term, fixed-rate loans?

Mr. **Beesley**. Yes.

Senator **Boren**. You imply in your statement that the loss of loan volume of the $1 billion a month is mainly due to borrowers leaving because of concern over the security of their stock. Do you also believe that the average interest rate, the problem of higher interest rates and the competition in some cases is a part of the problem?

Mr. **Beesley**. Yes, Mr. Chairman. Unfortunately, however, I do not think that our rates are necessarily higher than the competition. At least our policy is that they should not be higher than the competition. The problem is that rates are generally too high. We have a lot of borrowers who would not qualify for loans from any other competitive lenders at this point because of deterioration in their situation, and the rates for them are also too high.

It is not a question of necessarily being out of a competitive environment. It is just that the rates are too high, and we support your concept of interest-rate relief for all lenders.

Senator **Boren**. There is some comment here in your testimony about—and we have had some conversation about this—about a line of credit from the Treasury in lieu of direct appropriation. I am concerned about it. If this were done and joint and several liability were ended, could we not get in a situation where the associations could be forced to merge or face liquidation, individual associations or districts, before any assistance was granted? I just wonder if a line of credit were offered also in lieu of a direct appropriation, would the System be able to fully restructure loans? It would be cheaper in the long term, but maybe not cheaper in the short term to restructure those loans.

I am just concerned about, we are in a situation now where there has to be a certification that the entire System is in urgent need of assistance before it is made available—although we recognize that Congress does not have to wait for certification. Congress is free to act, Congress will act with or without a certification from the Treasury. We will proceed, we are not going to wait for such, whether we can meet all the technical requirements of certification, because, as we know, part of that problem is litigation, the whole question of what degree is joint and several liability, transfer of funds between districts going to be required, and since that is all in litigation, a lot of assets that might be available in theory are not really available.

Is there some danger that if we use the line of credit approach, that we might still see a situation where it would not maximize the loan restructuring and also might cause some individual districts or associations to get into jeopardy.

Mr. BEESLEY. Yes, Mr. Chairman, I think your concerns are valid. Let me say that one of the objectives we have outlined for a legislative package is a resolution of the litigation over the FCA's assessment regulations. The 1985 amendments are not working as intended. Congress will need to step in, we think, and set up a mechanism whereby banks can be assessed appropriately and the Capital Corporation can function appropriately.

Now, clearly, if the Congress intends that every association and district be maintained in a viable status, then there will be a price tag associated with that, and we would intend to try to quantify that.

If left to the current philosophies, my guess is that less costly solutions would be sought, including possibly the merger or liquidation of a district or association, provided the stockholders were protected.

Senator BOREN. But you do recognize the problem we might have if we use a line of credit approach as opposed to some sort of appropriation approach?

Mr. BEESLEY. Yes. The benefit of the line of credit approach that we suggested—and please understand, there is nothing in our suggestions that are cast in any kind of stone, obviously, we are trying to be helpful—was that, regardless of the accuracy of our numbers on the day that they are presented, immediately circumstances will begin to change. And, as previous witnesses have said, we are a mirror of the agricultural economy and it is going to be very difficult to pick a number which will solve the problem. We would like to see this be the last time we have to come here, and we would like to have flexibility built into the legislation.

Senator BOREN. It could be perhaps that we could use some direct infusions, plus a standby line of credit as an additional flexibility so that we would not get caught in these Catch 22 situations where we might have to wait too long. One of the problems we have had in the past is we have had to wait until the System had run down to such a degree before we really were in a position to get help, which makes the help more expensive and really debilitates the System before help is forthcoming, and perhaps we could even look to some sort of combination.

I know there is always the tendency from the Treasury and those that sit on the Budget Committee as well, there is a way of scoring lines of credit in a way in which the cost appears to be less excessive to the Treasury to start with, there is always the tendency to do that, but we are looking and hoping to find other ways so we can perhaps pay for what we are doing, but I would urge you to maybe focus and give us some advice about that problem.

Perhaps we should look at some direct infusion coupled with a line of credit, but maybe not exclusively a line of credit.

Mr. BEESLEY. Mr. Chairman, I cannot speak for the Treasury or the FCA, but I think that the System would agree with those two other organizations that there ought to be incentives in whatever legislative package there is to make the kind of reforms that Senator Boschwitz and others have recommended. We want to have our feet kept to the fire to the extent possible.

Senator BOREN. I agree with that.

If we warehouse acquired property in nonperforming loans in some way, would you support a provision that would require that preference be given to previous owners of the property in case of acquired property with respect to leasing or some other kind of possibility?

Mr. BEESLEY. Mr. Chairman, there again, if the preference results in additional costs to the stockholders of the System, we would probably expect or ask that that preference, that expense related to that preference, not be picked up by the other stockholders. We are trying to take the tack of using appropriate business measures that are in the best interests of all of our stockholders, weighing the paying ones against those that are in distress.

Senator BOREN. In other words, that is more or less a social value, and if there were any additional costs associated with the preservation of those families, say, on that land, those are costs that you think should be dealt with directly, rather than having the other——

Mr. BEESLEY. That is correct, and we would support that to be applicable to all lenders.

Senator BOREN. Yes. What about supporting a requirement that current borrowers be given the same options that are granted to new borrowers, for example, the same rate of interest? It is frustrating to see, and there are released reports that this happens, I think it has happened, where we failed to restructure loans, have not been willing to take the interest rate down as low as we could possibly get it for an existing borrower, then we turn around and offer that same land, a loan on that same land at a much lower interest to a new borrower.

Mr. BEESLEY. Mr. Chairman, we hear a lot of stories to that effect and that is in violation of our own policy, and as I have looked into the specifics of most of these, they are usually not quite as presented.

Our policy is that if we are going to take a loss in foreclosure, all—and when I say a loss, that means the legal fees and the writedown of the interest, everything else—that money should be available for us to work with the existing borrower to see if something can be done so he might be maintained on the farm.

Now, the borrower has to be able to show that if we do that he is going to be viable and he is going to be able to stay there. He has to have acted in good faith and not put himself in the position to receive this treatment by virtue of some scheme. But if we are taking a loss through a write-down of interest rates or through foreclosure, that money should be available to help existing borrowers stay on the farm.

Senator **Boren**. What about—in making that calculation, would you consider whether it is cheaper or not for the System, would you consider what you could sell that land for and what rate of interest you would loan the money out to buy that land?

Mr. **Beesley**. Yes, you would.

Senator **Boren**. So you would consider that, so that you would be prepared——

Mr. **Beesley**. That would be considered, right.

Senator **Boren**. I think that may be the problem and the way this is actually mechanically being carried out, but in some instances they might be underestimating the amount of principal write-down and the amount of lower interest rates that they are going to have to move toward in order to resell that land.

Mr. **Beesley**. That is very possible, and this is particularly true in a declining land value environment. You thought you could sell it for $100,000 when you made the decision and as it turns out you cannot get more than $80,000 for it and you made the wrong decision, perhaps.

Senator **Boren**. If that is the case, perhaps there could even be a mechanism set up that even at that point if there has been a miscalculation, I do not know if you can do this, allow the original owner of the land to come back in at some point, but that is one of the things that I think most frustrates and really enflames those that are being thrown off their land, if they turn around and then see others able to obtain that land and they are not even always in agriculture, some person who is not really a family farmer comes in and buys it for future speculative value at a price, at a much lower interest rate. If the farmer had been offered that same rate he may have been able to stay in business. It really seems to me that that is a terrible thing to have happen and we need to have some sort of a fail-safe device established in the System just to make sure it does not happen.

Mr. **Beesley**. Mr. Chairman, I agree with that. I hope that one of the guarantees, that this does not occur in any kind of widespread fashion, is the fact that the policymakers and the directors of the System are the farmers themselves.

It is a democratic process, and hopefully the policies are set to be sensitive to those other neighbors and friends.

Senator **Boren**. I will just ask you a couple more questions and then I will stop, because I know Senator Boschwitz wants to ask some questions and maybe I am covering some of the things he wants to ask as well, because we do have another panel still to hear from.

I am concerned about allowing unlike associations to merge. In my State, for example, 46 percent of all agricultural real estate loans are held by the land bank, while commercial banks and insurance companies have only 17.5 percent. The PCAs and intermediate credit banks have only 17 percent of the operating loans, and the private banking sector has 45 percent, almost a mirror image.

Could we assure that if we do merge these unlike units, that there would not be some indirect coercion for pushing these borrowers on the land into also utilizing the System for their operating loans?

Mr. **Beesley**. I do not know that that can be totally assured in every case. I think competition is healthy. I think that the creation of the secondary mortgage market will give some of our commercial bank friends access to long-term funds.

I think it is wholly appropriate, Mr. Chairman, if the stockholders of various organizations, for whatever reason they think is appropriate—to reduce costs, to streamline their operations, to try to become more competitive, and effective—if they want to merge, I think the statutory barriers to that should be eliminated.

You may be interested, if I could just say that at the resolutions committee where this issue was addressed, there were two districts that either abstained or opposed this, and those were the Wichita and the Texas districts. There is strong sentiment in this regard in the Northeast and in Baltimore, where they have been operating jointly for generations, and they have to go through this charade of maintaining three separate entities.

Senator **Boren**. Would there be any objection to some very strong standard of some regulation being imposed forbidding the conditioning in any way, direct or indirect, of loans on land conditioned upon using the System for operating loans as well and vice versa, depending upon the loan situation?

Mr. **Beesley**. I think if there is any such language, it should apply to all lenders. If everybody is playing by the same rules and the Congress thinks those rules are appropriate, we should not complain.

Senator **Boren**. What is the position of the Farm Credit Council with respect to continuing joint and several liability?

Mr. **Beesley**. The current position of the System is that joint and several liability is appropriate if the other mechanisms are in place to deal with problems and if the assessments are established so that capital flows to the Capital Corporation in a reasonable fashion as opposed to the current FCA regulatory structure, and then we would maintain joint and several liability. We think that there would be a significant cost to the marketplace if that were set aside.

Senator **Boren**. All right. What about the future stock purchase requirement, would you favor total elimination of borrower stock or would you favor maintaining some kind of requirement to borrower stock?

Mr. **Beesley**. Well, Mr. Chairman, prior to the Denver meeting my position was that borrower stock probably should not be required in the future, but the directors unanimously supported maintaining borrower stock in the System.

Senator **Boren**. Did they address this question I asked earlier of one of our witnesses about the idea of the guarantee? In other words, I would assume that one of the reasons why the System would want this is again the feeling of maintaining local control, that there should be stockholder participation.

Mr. **Beesley**. That is right.

Senator **Boren**. We all understand and we agree with the need to permit and to reassure members about borrower stock now, the guaranteed borrower stock now. Was there any discussion about whether or not that guarantee should be permanent or whether in the future, once we get the System back on a sound footing, if there should be perhaps some degree of risk or that the borrower-stockholder should be to some degree at risk in the future, any——

Mr. **Beesley**. Yes, there was much discussion on those topics, Mr. Chairman, and I was again a little surprised by the consensus that emerged. There is not a consensus, in fact there is a consensus against the guarantee of borrower stock, that, rather, using the Capital Corporation to protect borrower stock only in those districts and associations that actually need financial assistance and not to change the historical relationships in the rest of the banking system.

They want this protection mechanism to be as short term as possible. There is a strong desire for the System to get away from the Government. We had Federal assistance in the System before, and they celebrated the repayment of it. They recognize the need that it may have to come back for a short period of time, and they want to minimize the amount and they want it to be as short term as possible.

Senator **Boren**. That is a very interesting solution to reach in the meantime. I think in terms of understanding the need for the System, to maintain a real interest in the System for the stockholders too—I am glad to hear that a consensus was reached, that we maintain stock. I am glad to hear that there is some thought that there at least be some partial risk involved in the System in the future, although I think we all realize that during a transition period in order to reassure everyone involved, in order to prevent the flight of borrowers, we need some sort of a transition mechanism here, a reassurance mechanism until we get everything back on solid footing.

It sounds to me like the advice from the grass roots has been pretty good on these points.

Mr. **Beesley**. Mr. Chairman, I might just say at the meeting analogies were made, of course, as you might expect, to New York City, Chrysler, and so forth. The System has faced tremendous losses as a result of its being solely involved with agriculture. They need some help perhaps to get through, but they have no desire to be permanently subsidized or supported by the Government at all.

Senator **Boren**. Well, that certainly has been the history and everything has been—and I certainly think that this committee and the Senate will look toward whatever is done temporarily to be ultimately repaid, as it was done in the past. We certainly have had a history of that and the System has established itself as having a strong desire to do that and to get back on its own feet again, and I have every confidence that if and when, because I think it is a foregone conclusion we will have to, that we have some emergency assistance that will be repaid.

Let me turn to Senator Boschwitz now for questions and then after that we will—let me just look and see—we can either—we are going to need to break at about 1:15. We could—I do not know how long we have this afternoon.

Let me ask Mr. Hankes and Professor Harl and Mr. Dahl, where are you? I do not know if you can caucus.

Mr. **Hankes**. Between the two of us, it will take 15 minutes at the most.

Senator **Boren**. Would you rather go before we break at 1:15, if we have time?

Mr. **Hankes**. Yes, if we can get more Senators after lunch.

Mr. **Harl**. Before.

Senator **Boren**. All right, we will try to go as quickly as we can. Senator Boschwitz and I do not limit you by that.

Senator **Boschwitz**. Mr. Chairman, now your side of the aisle must sit through all these hearings and we get up and come and go.

Senator **Boren**. As you know, with my bipartisan spirit, I am always happy for you to take the chair, you know that. [Laughter.]

Senator **Boschwitz**. Let me ask about the Denver meeting for just a moment. I understand that 12 presidents were at the Denver meeting.

Mr. **Beesley**. All 12 presidents were at the Denver meeting and all of the—not all, but most of the directors of the 12 districts were there, probably about 110 people in attendance.

Senator **Boschwitz**. When you said that they wanted to continue the borrower stock, did they want to continue to buy the 10 percent level that presently exists for the land bank and the PCA's?

Mr. **Beesley**. No, the preference would be—and I do not know whether this is in the specific proposal—but the preference would be to provide more flexibility in the statute for the amount of borrower stock to be established on an institutional basis.

Senator **Boschwitz**. Does the statute presently require the 5 and 10 percent, or is this flexible?

Mr. **Beesley**. The statute presently requires 5 percent in the land banks, and I think there is some flexibility in the PCA's, that is right.

Senator **Boschwitz**. Obviously, it is hard to be competitive when you have to put up 5 percent on which you pay interest, unless you have sources of funds. So they want more flexibility?

Mr. **Beesley**. They want more flexibility. The System realizes, and I am sure the borrower realizes, that interest rates have to be adjusted to take the stock into account.

Senator **Boschwitz**. You mentioned that there were 3,800 loans that were restructured in the entire System, is that correct?

Mr. **Beesley**. That is correct.

Senator **Boschwitz**. And how many loans are there that are thought to be in some type of jeopardy. There must be hundreds of thousands.

Mr. **Beesley**. There would be somewhere between 100,000 and 200,000.

Senator **Boschwitz**. Well, that is a very broad range, but even taking the lower side, that means 4 percent of the loans have been restructured. You were here this morning when Senator McClure was testifying. He was very critical of his own 12th district that had restructured only 3 percent of the so-called nonaccrual loans, and perhaps that is a different standard than the 100,000 to 200,000.

How many of those 3,800 have been found in my district, the 7th district?

Mr. **Beesley**. At this point, the 7th district's loan restructuring program would exceed the other 11 combined by wide margins.

Senator **Boschwitz**. With all due respect to my friend, the chairman of the subcommittee, who is concerned that people are going to go out and buy land for future speculative value, I am not sure there are a lot of people out there who are going to do this at the present time. I am told in our district that 95 percent of the purchases that are made are made by people within a 5-mile radius, as I recall the figure.

I must say that I am quite concerned that the other 11 districts are sitting there, waiting for legislation. They are going to see if we are going to establish a Capital Corporation. I would say to my friend from Oklahoma, that those 11 districts that Mr. Beesley pointed out, that out of the 3,800 loans that were restructured, the restructuring that occurred in the 7th district (my district) exceeds the other 11 put together.

Senator **Boren**. Put together, right.

Senator **Boschwitz**. And these guys are sitting out there waiting to see if we are going to form a Capital Corporation where they can dump their bad loans and dump their high-priced bonds. So they are just sitting there waiting. What kind of conversation, Mr. Beesley, went on at Denver? How was St. Paul regarded?

Mr. **Beesley**. To be very candid, Senator Boschwitz, I think some of the other districts are somewhat concerned that perhaps the restructuring activity is overly aggressive and will result in borrowers who could otherwise make their payments electing not to make their payments, but I think the general idea is to watch and try to see what happens.

I do not think that any district is sitting on its hands and waiting. There is a lot of——

Senator **Boschwitz**. They are not restructuring.

Mr. **Beesley**. They are not restructuring to the degree that St. Paul is. There are a lot of new people in the System, over half of the bank presidents have changed in the last year and there are simply different views as to what is the most appropriate way to collect or recover on problem loans.

I think we have a policy in place that all of the districts have adopted, which I described earlier, and that is that a loan has to be restructured or should be restructured if you are going to take a loss in foreclosure anyway, but I guess some folks are wondering out loud about the viability of the restructured situation or whether something has been left on the table.

I think that what is going on in St. Paul is extremely important. I think the rest of the System is watching it closely, and all of us hope that it will work and if it does that it will be a pattern that the rest of the System will follow.

Senator **Boschwitz**. How long are they going to wait? Are they improving the situation of these nonaccrual borrowers by not restructuring and just letting them hang there by the deficit.

Mr. POTTER. I would like to suggest, Senator, that we are not waiting.

Senator BOSCHWITZ. I am sorry, I was not here when——

Mr. POTTER. I am Travis Potter. I am a farmer from Iowa and am a member of the Omaha board. We have watched St. Paul closely. We have hired a new CEO from commercial banking who went in in January. At our February board meeting, we have adopted a recovery plan for Omaha that, while if not just exactly like St. Paul's, it parallels it very closely, and our plan is to restructure loans, $300 million worth in the next 3 years.

Senator BOSCHWITZ. Well, I am pleased to hear that. I know that the Omaha district has been having its problems as well. The interesting thing is that probably St. Paul, if it goes forward and moves along, might penalize itself, in a way. Perhaps it should wait for the Capital Corporation to come along and discount its loans and give them to the Capital Corporation and give its high interest bearing bonds to the Capital Corporation.

Sure, its capital is going to be impacted by that, because it is not going to get full value for the loans that it gives up. I almost believe that one of the reasons I am so interested in getting things moving here is that I agree with you. We have got to hold these fellows' feet to the fire and get them going.

Mr. BEESLEY. Senator Boschwitz, Mr. Buegler came up to me at one point in the conference and he had heard—he said, "Now, do I understand the loan restructuring is our first priority, and in our business plan it is our number one priority." I said "yes, it is," and he was frustrated himself with some of the discussion that was going on because it was stated at the meeting by one of the experts in this area that probably only 5 percent of the loans to the Farm Credit System can and should be restructured, and that individual is charged, is one of the individuals working at the Capital Corporation, who is charged with loan restructuring for the Capital Corporation.

So we have some differences of opinion as to how many loans should be restructured, although we have no differences of opinion as to what the approach and the philosophy ought to be.

Senator BOSCHWITZ. I do not want to just dwell on the business of restructuring. I just use it as an example, as well as the land sale that they have done in a most aggressive way. They have gotten things moving up there. I do not know exactly what their loan pattern is, but I bet they have restored the confidence of borrowers in the System to an extent larger than other districts. Are you aware of any statistics of lack of borrower flight or anything that would support that kind of an assessment?

Mr. BEESLEY. I am only aware of anecdotal evidence that would support the notion that the borrower confidence in the System is much improved in St. Paul compared to some of the other parts of the System where it was——

Senator BOSCHWITZ. Well, it has to be. As I said earlier, if somebody can go in and take charge, I am not so sure that we have to fool around with the rules and regulations. I do not think that there should be that much B stock required. Perhaps some changes are necessary, but apparently even under the existing rules and regulations of the Farm Credit Administration and the System and all the other entities involved, you can repair yourself.

I must tell you that from my standpoint I want to see the Farm Credit System continue. Local control seems to be a great cry and that should be continued. If there is a strong head of a district, that would be just fine.

But I think that, again, we should find some strong and aggressive people who are willing to move in the way that Mr. Buegler has and then if you find that you do not have enough capital, go out and borrow some or guarantee it, but get on with it. I think that there is not much wrong with the Farm Credit System that has not been reviewed several dozen times here at this committee and through correspondence and speeches. The System appears to have the capability of repairing itself and I would say to the System that I hoped that the folks out in Denver would come to that conclusion, but apparently they did not. They are going to wait and see. What are they waiting for?

Mr. BEESLEY. Senator Boschwitz, I am the chairman of the presidents' committee and when the presidents are around the table like this, we all agree that loan restructuring is our number one priority and we all agreed on a policy of how loans should be restructured, and virtually every district that has a problem has created special asset teams to go out and deal with it.

There is a genuine sense of disagreement as to what is viable, I guess, and what is appropriate. Everybody wants to restructure loans and get on with it. Nobody is waiting for the Government to step in. We have a desire to minimize and avoid if possible any Federal funds in the System.

There is an honest disagreement among the presidents as to the appropriateness of what is going on in St. Paul, that is all there is to it.

Senator BOSCHWITZ. I was not in Denver, but I find it difficult to believe that they are out there chugging along and being aggressive and trying to remedy their own ills. They are waiting to see what we are going to do. They are waiting to see how much they have to do, and from this Senator's standpoint, that is unfortunate and it certainly does not improve their chances of getting Federal assistance.

I would hope that we might not micromanage this System and try to come up with all kinds of new rules and regulations. Everybody realizes why the System is in trouble. What is it about the St. Paul method that they find so debatable?

Mr. BEESLEY. There are two things, and again, please, I hope no one here would misunderstand, the System is anxiously hoping and encouraging what is going on there.

Senator BOSCHWITZ. They are talking. I mean they restructured 3,800 loans.

Mr. BEESLEY. The two concerns——

Senator BOSCHWITZ. Over what period of time?

Mr. BEESLEY. There are two concerns that we——

Senator BOSCHWITZ. Over what period of time was that done?

Mr. BEESLEY. 1986.

Senator BOSCHWITZ. In 1986.

Mr. BEESLEY. Yes.

Senator **Boschwitz**. That is a concern.

Mr. **Beesley**. The two concerns that were raised are, one, that good borrowers who comprise the vast majority of the System will find it convenient or appropriate to stop making their payments if the worst thing that is going to happen to them is that the loan get restructured.

The second thing that the presidents are concerned about is——

Senator **Boschwitz**. Is there evidence of that?

Mr. **Beesley**. Yes, there is some evidence. I do not know specifically as to St. Paul, but there were cases discussed, there are some attorneys and accountants that are advising their clients not to repay because the worst thing that could happen is you get your loan restructured.

Senator **Boschwitz**. Well, from my business experience, do it fast in that case, say you are going to do everything within the next 90 days. Most of these payments are once annually, as I recall. Do it quickly and get it done and do not give them a chance not to pay.

Mr. **Beesley**. Well, you asked what the concerns were. That was the first one. The second one is the associated cost. They are not convinced that it is the least cost solution that is being utilized but, rather, in some cases the easiest solution.

I am not attempting to agree or disagree with the concerns raised. I am just stating what they were. I think everybody in the System is awfully hopeful of what happens there will work and that it can be a pattern to be used throughout the System, and we fully support the St. Paul district and its efforts.

Senator **Boschwitz**. Well, I listened to words like "awfully hopeful" and "concern" and all that kind of stuff. I guess we had better go on to the next witness, but I must tell you that if I were in Georgia, I would look for a little action.

Senator **Boren**. I agree with you.

Thank you very much. I am glad to see that there was much understanding at the Denver meeting, that we are moving and that we have input from the System and that this is not something that is going to wait any longer for us to deal with it.

Mr. **Beesley**. Thank you very much.

Senator **Boren**. Mr. Hankes, Mr. Dahl, and Mr. Harl. We might let all three of you, we will not intervene with questions between you. We will start with Professor Harl and then Mr. Hankes, and then Mr. Dahl, and go right down the list, if that is all right.

Would you like to go first?

Mr. **Hankes**. I would like to go first, if I could.

Senator **Boren**. Go right ahead.

Mr. **Hankes**. Thank you.

Senator **Boschwitz**. Do you have a prepared statement?

Mr. **Hankes**. Yes.

Senator **Boschwitz**. Fine.

STATEMENT OF RAY HANKES, CHAIRMAN, FARM CREDIT TASK FORCE, NATIONAL PORK PRODUCERS COUNCIL; AND NEIL E. HARL, PROFESSOR, IOWA STATE UNIVERSITY, CONSULTANT, NATIONAL PORK PRODUCERS FARM CREDIT TASK FORCE

Mr. HANKES. Thank you for the opportunity to provide some input today. I am Ray Hankes, vice president of the National Pork Producers Council. I have a farrow-to-finish operation in Illinois and produce about 5,500 head of hogs a year.

I also serve as chairman of the National Pork Producers Farm Credit Task Force. With the Farm Credit System accounting for over half of all farm borrowing, the task force I chair has met several times with some of the Nation's leading experts on this extremely complex subject. We have and will continue to work closely with other agricultural groups on the farm credit issue.

At the recent annual meeting of the NPPC, elected delegates representing producers from 45 States made it clear that their first concern at this point is saving farmers, rather than the System itself. They agreed that interest rates must be competitive for all borrowers, not just the best borrowers.

While the Nation's pork producers believe the current System is worth saving in some form, they feel the surviving System should remain a co-op, with more, not less, local control.

NPPC's policymaking delegate body supports creation of a secondary market for farm mortgages, to be available to all lenders for farm real estate loans. That increased availability of funding should bring greater competition in providing for farm credit needs, resulting in lower interest rates.

If a capital infusion is needed to rescue the Farm Credit System's viability, we feel strongly that it should not be at the expense of existing agricultural programs. Any Federal aid to the System should be linked to a reorganization plan that assures a long-term solution to the System's chronic problems. The primary goal, in the goal of the Nation's pork producers, is providing maximum possible assistance to meet farmers' credit needs.

We feel consideration of any System request for aid should be given in a properly, deliberate manner to insure maximum farmer input while protecting borrowers' current equity. In that regard, Mr. Chairman, the Nation's pork producers appreciate the opportunity to present our views on farm credit legislation before this committee.

I respectfully point out that in the past two congressional efforts to rescue the Farm Credit System, agricultural commodity groups such as ours were not provided an opportunity to comment on the specifically proposed legislation after it was brought forward and laid on the table for discussion. The some 100,000 pork producers who we represent would fully expect to be provided the opportunity to comment on the specific piece of legislation reported out of this committee prior to it being marked up.

A number of farm organizations met this morning prior to this hearing and are working together and feel that this is the way that we are going to solve the problem. We are here today, Mr. Chairman, to present farmer input on this critical issue. NPPC's Farm Credit Task Force asked Dr. Neil Harl, distinguished professor of economics at Iowa State University, to prepare a detailed report encompassing the various recommendations endorsed by NPPC's delegate body concerning restructuring the Farm Credit System. We are submitting that report for the record and will not go into it in full detail.

Dr. Harl, as I am sure you are well aware, is one of the Nation's leading authorities on agricultural law and economics. I am honored to turn the rest of the comments for the National Pork Producers Council over to him.

Thank you.

Senator BOREN. Thank you very much.

Professor Harl.

Mr. HARL. Thank you very much, Mr. Chairman, Senator Boschwitz. I am pleased again to have this opportunity to be before you on behalf of the National Pork Producers Council.[1]

As the prepared longer statement indicates, we believe there are both short-term problems and long-term features of the problem faced by the Farm Credit System. The short-term problem is how to achieve institutional stability in the present economic environment of the rapidly disappearing reserves and all that goes with that.

The longer term problem is how to restructure to meet the credit needs of agriculture over the next half century ourselves. We are all acutely aware of the near-term problem but I would emphasize the importance of giving adequate attention to the longer term aspects. We are all interested in the long-term health of agriculture and a viable Farm Credit System can contribute to that state of health.

Our comments today are from an external perspective. Our focus is influenced by what we perceive as the credit needs of the sector and by the plight of heavily indebted farm borrowers. We also recognize the realities of our economic environment: One, a severely weakened and substantially downsized Farm Credit System, two, heavy concentration of debt among farm borrowers, with about one-third of the farmers holding about two-thirds of the debt; and, three, budgetary constraints on governmental assistance.

We would like to make five points very quickly, Mr. Chairman. First, we believe that a secondary market could make a substantial contribution to agricultural lending long term. We view the secondary market as a source of credit and as a risk management tool for lenders. One of the serious problems for many agricultural lenders is lack of diversity of their loan portfolios. Certainly that is the case of the Farm Credit System and one of the root causes of its present problems.

Because agriculture is periodically afflicted with great economic stress, adequate credit enhancements may be necessary to enable the secondary market in farm loans to withstand periods of diversity, like the 1930's and the 1980's. We suggest a combination of guarantees initially and accumulated reserves as shown in figure 1 of our testimony.

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[1] See p. 462 for the prepared statement of Professor Harl with accompanying report on restructuring the Farm Credit System.

It is also our belief that a secondary market should be accompanied by adequate regulatory authority and an appropriate level of farmer involvement and control to assure fair and reasonable access to the market by all eligible lenders. We view that as a long-term solution, with modest implications in the short term.

The second point involves the problem of marshalling reserves to assure that bonds and notes will be repaid on schedule. The present system of reliance on stronger districts responding in support of weaker districts has not worked particularly well. It seems unwise to continue such a procedure for responding to adversity. One possibility we believe with merit is to create an FDIC-type fund with reserves accumulated in that fund in better times, rather than being accumulated at various places in the 12 districts and later pried out of the stronger districts, the healthier districts in support of the weaker ones.

The third point is to move toward greater autonomy at the district level, as each bank is viewed as a separate center for purposes of control and the purposes of profit and loss. This type of decentralization would help to bring to the System a degree of externally imposed market discipline.

The fourth point is that some district banks will need help if they are to survive. This is the near-term part of the problem. That assistance could come in any one of three ways.

One, an adequately funded program enabling purchase of troubled loans by the Capital Corporation. It would take adequate funding and it would take the right marching orders to see that that happens.

Second, it could occur with a direct infusion of capital to weakened district banks by the Federal Government, which we would assume would come with a measure of Federal involvement and decisionmaking in those districts for the term in which that takes place.

Third, a targeted program for interest buy-downs for borrowers. The interest buy-down approach offers several advantages, not the least of which is that it addresses the root cause of the problem, rather than the symptom. To bring a modicum of stability to agriculture, it will be necessary to bring down interest rates to roughly the rate of return on farm assets. If farmers as borrowers can be made substantially stable, then derivatively it would stabilize lenders as well, and stabilize the borrowers, otherwise we run the risk of creating a golden sieve, and pouring capital through that sieve and right out again, if farmers as borrowers are not substantially stable.

It is a System problem and not only are we concerned about stabilizing lenders, we are concerned about stabilizing the rural communities, since it is indeed a System problem. With external assistance of some type, troubled district banks could gradually rebuild their own capital base. Our figure 1 discusses this and reflects it in some detail.

Finally, we would recognize that significant amounts of funding will be required for any rescue operation. We would question the diversion of funds from price and in some support programs, would place an additional segment of farmers at risk and increase the need for targeted intervention if an objective is reasonable stability.

I would like to make one final point——

Senator **Boren**. This is separate from the farm program?

Mr. **Harl**. Right. I would like to make a point relative to restructuring. Certainly, I would endorse all of the comments that were made. We believe that for all programs of assistance, it is vital for the parties to recognize the importance of loan restructuring, rather than loan liquidation. Loan restructuring is appropriate in all instances whenever management skills are not in question and the borrower demonstrates the ability to become stable at a lesser cost than would be incurred with loan liquidation through foreclosure or other credit action.

It is my view that the willingness to consider restructuring is directly proportionate to the amount of time the area has been under stress. As I have traveled around the country, I find the greatest unwillingness in areas that have just recently moved into periods of heavy stress. I think that is in part responsible for why we have differences around the country in that respect.

Mr. Chairman, Ray and I will be happy to respond to any questions of the members of the subcommittee, as you move to that stage.

Thank you.

Senator **Boren**. There are some areas, let me assure you, that have been under great stress because they have not restructured.

Mr. **Harl**. Yes.

Senator **Boren**. We have seen that and I do not know if that is because they are even more concerned about the delicacy of their own financial situation.

Mr. **Harl**. I think that is a factor, yes, sir.

Senator **Boren**. You get yourself into such a severe problem that you do not even have the incentive to go ahead and restructure.

Senator Boschwitz is going to have to depart, and he wanted to ask one question, I believe, and he will break in here just for a minute.

Senator **Boschwitz**. I just wanted to ask you, Professor Harl—whom I very highly regard—your assessment of how the 7th district is doing? I believe it is the only district that is restructuring by adjusting the principal as well as the interest.

Mr. **Harl**. Senator, I have communicated directly with that system within the last 3 weeks in discussions with them, and I am very supportive of what they are doing. I think it is an overdue move and I would certainly endorse the approach that they are taking in the St. Paul district. I think it makes a great deal of sense.

I think it would have been better had it come a year ago or even longer, but I certainly believe it is in the right direction.

Senator **Boschwitz**. Well, I do, too, and I am glad to hear you say that.

Mr. **Dahl**. Senator Boschwitz, if I could comment, I am from North Dakota, in your St. Paul district. The program that you are talking about is met with good acceptance. It seems to be working.

I listened to your comment a little bit earlier about showing North Dakota 4.9 percent. They might be a little bit low. I am just wondering, with all the water in the 10,000 lakes you have and so on, if you have ever had an offer for Minnesota. [Laughter.]

Senator **Boren**. I am glad you asked that question.

Senator **Boschwitz**. He is a witness. [Laughter.]

Senator **Boren**. The Chair rules that the witness may ask the ranking member any question that he desires.

Senator **Boschwitz**. We will sell you one of those lakes. [Laughter.]

As a matter of fact, a lot of your folks from the eastern part of the State come over. I walked in a parade once in Detroit Lakes, Minnesota, and I think I saw more North Dakotans than I did Minnesotans, so I scheduled elsewhere the next Fourth of July. [Laughter.]

Senator **Boren**. We will get this back on the appropriate topic now.

Senator **Boschwitz**. Thank you very much.

Senator **Boren**. Thank you, Senator Boschwitz.

Let me put one last question to Professor Harl. When you talk about giving more power, you talked about decentralization to some degree in concern of giving more authority and accountability to the district levels.

Mr. **Harl**. Right.

Senator **Boren**. What role do you see the local associations having in this picture?

Mr. **Harl**. I certainly see the importance of maintaining as much local control as we can. We do state in our report that we believe it is important to have local control by farmers, but that we have professional management at all levels of the System. So we do not mean to suggest that is not important, we think that it is, and we can allocate responsibility for problems in part as the basis of perhaps all of these things, but we do believe that it is vital that there be as much local control as possible relative to the affairs all the way up through the System, including the secondary market, which we spoke approvingly of.

Senator **Boren**. Yes. Thank you very much.

Mr. Dahl, you got in some good words already before Senator Boschwitz left and we would be happy to receive your statement, which I believe is given on behalf of you as president of the National Cattlemen's Association.

Mr. **Dahl**. Yes, sir.

Senator **Boren**. We are happy to have you and I apologize. I assure you that you are last but not least, and we appreciate you being here.

STATEMENT OF JACK DAHL, PRESIDENT, NATIONAL CATTLEMEN'S ASSOCIATION

Mr. **Dahl**. Thank you, Mr. Chairman.

My name is Jack Dahl, and I am president of the National Cattlemen's Association. We represent here about 230,000 cattlemen around the United States. We appreciate this opportunity and we especially appreciate, Mr. Chairman, your enthusiasm and your aggressive approach to this very critical problem of agricultural credit and the Farm Credit System.

With your permission, sir, I would like to, in the interest of time—and I do not like to read very much anyhow—my prepared statement will be a part of the record.[1]

Senator **Boren**. We will put your prepared statement in the record.

Mr. **Dahl**. I would like to summarize the six points, if I could, that really summarizes what this testimony is.

The National Cattlemen's Association believes that, number one, legislation reestablishing the existing borrower and new borrower confidence in the Farm Credit System is essential. We should continue streamlining the Farm Credit System, should allow local Farm Credit System entities to explore creative methods of raising capital, and we need to create a secondary market for agricultural mortgages so more rates and term options are available to buyers, we need adverse credit and nonperforming loans to be restructured and worked out.

Legislation should include the financial banking to effectively accomplish this key element. Finally, any legislation must recognize that the problem is larger than the Farm Credit System.

Senator **Boren**. Yes.

Mr. **Dahl**. Mr. Chairman, the National Cattlemen's Association has an agricultural credit task force that represents every region of the country. We represent borrowers of the Farm Credit System, the Farmers Home Administration, private lenders, bankers, and all of them are cattlemen.

Our task force has met a number of times in the past year and we have worked with you and your committee and Congress. We will continue to do that. We will be meeting here in town next week. We presently have six proposals that the task force is looking at that have come from all aspects. We are trying to digest that and we will be presenting you and your committee with a proposal next week when our board of directors meet here. We would hope that could be a part of the record of this hearing.

Senator **Boren**. It certainly will. We will receive that for the record.

[The following material was subsequently received for the record:]

Agricultural Credit Act

Title I: Secondary Market: Create a secondary market within the Farm Credit System, open to all regulated agricultural lenders for mortgaged-backed agricultural loans.

Title II: Farm Credit System Recapitalization:

Section A: To assure long term viability of the Farm Credit System, create a System funded insurance fund, similar to FDIC.

Section B: While the insurance fund in Section A is being funded, the Farm Credit System shall utilize a line of credit through the Farm Credit Capital Corporation to:

(1) Purchase nonperforming loans and high interest bonds, appropriate current market asset values, from Farm Credit System entities.

(2) Provide capital infusions to FCS entities with inadequate capitalization.

(3) The FCCC and funding authorized under this section would sunset five years after date of enactment.

Title III: Restructuring the Farm Credit System:

Section A: The FCS may have to, in some Districts and/or Associations, restructure to become more efficient and viable lenders. This Title would make appropriate legislative changes so that borrow/stockholders would have the flexibility to restructure local and District entities.

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[1] See p. 467 for the prepared statement of Mr. Dahl.

Section B: Possible changes to enhance shareholders ability to restructure include:

(1) Guarantee of borrower "B" stock, but borrower stock would be phased out as loans are retired. New loans would require the borrower to establish an at-risk, capitalized stock investment (hard cash).

(2) Allow discretionary lending across geographic boundaries.

(3) Recapitalize entities (PCA's and FLBA's) through issuance of nonvoting preferred stock (option available).

(4) Merge unlike entities (PCA's and FLBA's).

(5) Full lender status for FLBA's.

(6) Allow viable entities to become OFI's.

(7) Provide for outside Directors.

(8) Replace joint and several liability with the insurance fund.

(9) Remove legislated loan terms, established by regulation.

Title IV: Borrower Rights and Responsibilities:

Section A: The FCS must recognize an obligation to minimize costs of regulation to borrowers, and,

Section B: Borrwers shall have all rights and responsibilities presently accorded members of any duly formed cooperative.

Title V: Interest Rate Reduction:

Section A: Several provisions will result in significantly lower interest costs to borrowers, including:

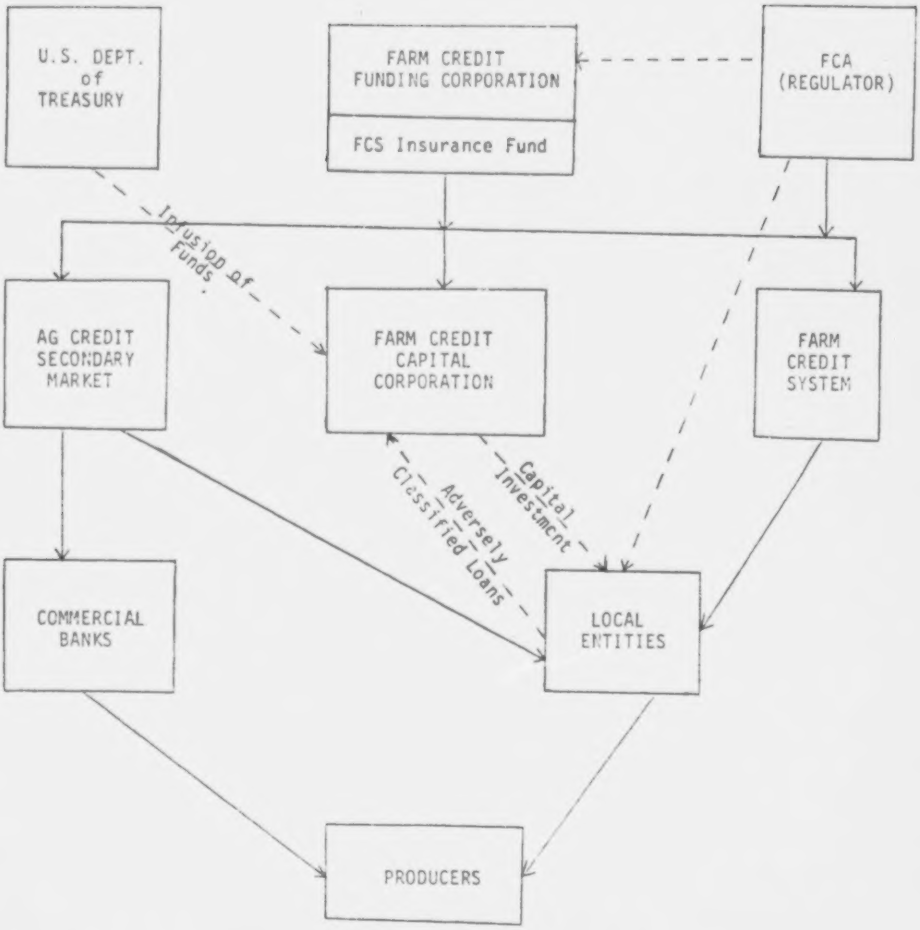
(1) Reduced administrative costs.

(2) Reduced costs of carrying nonperforming loans and acquired assets (which are transferred to the Capital Corporation).

(3) The explicit federal guarantee of FCS obligations through the Capital Corporation line of credit (and, later, insurance fund).

(4) Increased competition for agricultural loans, via the secondary market.

Section B: Other initiatives for interest rate reductions may be helpful during a transition period. Such initiatives should apply to borrowers of all regulated agricultural lenders.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FARM CREDIT FUNDING CORPORATION
FCS Insurance Fund
FCA (REGULATOR)
Infusion of Funds
AG CREDIT SECONDARY MARKET
FARM CREDIT CAPITAL CORPORATION
FARM CREDIT SYSTEM
Adversely Classified Loans
Capital Investment
COMMERCIAL BANKS
LOCAL ENTITIES
PRODUCERS

Senator BOREN. Let me say also, we would value your input. You have heard some of the questions that have arisen today, questions about continued purchase of stock versus not continuing that, whether or not we should have temporary guarantees or permanent guarantees on stock, whether we should have joint and several liability as we have now or an insurance fund. These are obviously some of the other questions.

I think the secondary market point you make today is a very important one. We would value your input on any of the points, including the points that I listed in my opening statement and the other kind of open-ended questions that have arisen.

We do hope we will be able, whether we will actually commence our markup before the Easter break or not is a little bit up in the air at this point. We obviously cannot move to any kind of completion until after the Easter break, until we have the financial estimates in, because we hope to have them by the 20th of April, but we are going to move ahead, not precipitously, but with dispatch.

I think we all realize the longer we wait the worse the problem is going to get and that has been the problem as I have seen it over the last 2 or 3 years. We have gone to creative accounting, we have gone to every method we can think of to disguise the full range of the problem and obviously Congress does not like to face up to situations that involve cost. We are all acutely aware of trying to hold the budget down. So if we can find creative ways not to face up to the problem, we do that. The agricultural community itself I think has been a community that time and time again could solve its own problems if it wanted to, the System has wanted to, but I think we realize we are going to have to solve the problem.

I certainly will reflect on the summary points you have made today. Is there any other point that you would like to add?

Mr. Dahl. Mr. Chairman, just that we are very pleased to be able to work with you and your committee and also all of the other agricultural groups. I think that it is going to take some common ground here to come up with a proposal and then it needs to be totally supported by all of agriculture to get it down.

Senator Boren. Well, I think from where we started even a month ago, in listening to the various groups testify, listening to comments that are coming from the System, I have had some meetings with the regulators as well, you know, I will not say that we are together on everything by any means yet, but I do see things moving this way and from a polar position moving toward a consensus and we are very optimistic that we will be able to do that.

I apologize that we have kept you so long. We are going to have to stop now so that we can resume again. We will try to resume about—it will probably be about 10 minutes past 2:00 p.m., and we will be in room 438A, which is just upstairs.

We will stand in recess until that time. We thank all of you for your participation.

[Whereupon, at 1:27 p.m., the subcommittee recessed, to reconvene at 2:10 p.m.]

AFTERNOON SESSION

Senator Boren. The subcommittee will come to order.

We will begin with Luman Holman, executive director of the National Association of Farm Credit System Stockholders, and also with Dean Biery, director, Production Credit Association of Northern Ohio, and I think some of you may have others with you.

Why do you not come up to the stand now and we will commence with Mr. Holman. I think you are also representing the Federal Land Bank Associations of Texas Stockholders' Defense Fund, wearing two or three hats here.

STATEMENT OF LUMAN W. HOLMAN, ON BEHALF FOF GRASSROOTS: THE NATIONAL ASSOCIATION OFF ARM CREDIT SYSTEMSTOCKHOLDERSANDTHEFEDERALLANDBANKASSOCIATIONS OF TEXAS STOCKHOLDERS' DEFENSE FUND

Mr. Holman. Mr. Chairman and gentlemen, let me first say to you that my name is Luman Holman and I would like to have my comments, if I might, recorded in the entire record, if you please, sir.[1]

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[1] See p. 469 for the prepared statement of Mr. Holman with attached bill for the relief of the Farm Credit System.

Senator BOREN. We will.

Mr. HOLMAN. I will try to summarize, in the interest of time.

First of all, let me say that we are very pleased to have heard the testimony already this morning and we are in agreement with most of what we have heard. In addition to the testimony that I present, we also present a bill which is very similar to most of the testimony that we have heard today.

I would like to commend you, sir, for the very excellent way in which you have handled these hearings and previous hearings and the dispatch with which you are moving, because it is of extreme importance that these needs be met and met promptly, and for that we are grateful for your leadership.

Senator BOREN. Thank you.

Mr. HOLMAN. The aim of these shareholder organizations that I represent is precisely the aim set out in the policy and the objectives section of the Farm Credit Act itself, namely, "to encourage farmer- and rancher-borrowers' participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit."

In my testimony before this subcommittee on February 26, 1987, I discussed the ruinous and troublesome problems confronting us:

First of all, the continuing failure to give interest rate reduction and foreclosure relief to the Farm Credit System borrowers themselves;

Second, FCA's continuing failure to do what Congress intended and to implement the 1985 and the 1986 amendments in a way that would allow the banks in the System to help the borrowers, with emphasis on that word "borrowers";

Third, the continual lust for power by System officials to seize the control of this System by a proposal to replace the present 37-bank System with a single entity or a super bank. These we find are continuing and very troublesome problems.

Finally, in item four, let me suggest that there is a clear need for legislation to address these problems and to restore the focus of the System institutions to that of helping the farmer and rancher borrowers.

In that testimony, I discussed the meeting that Grassroots held in Des Moines, Iowa, last winter, attended by people from each of the 12 farm credit districts in order to discuss new legislation. In my earlier testimony, I outlined the nine principles that were agreed to at the Des Moines meeting, as well as four additional borrower rights proposals to ensure that farmer-rancher borrowers are treated fairly. We ask for no more than that.

Today, I have attached to my testimony a proposed bill, with 10 titles, and these 10 titles put into legislative language the goals that I have outlined earlier. Also attached is a section-by-section analysis of the bill.

The first three titles are aimed directly at helping the farmers and include:

Title I, providing for interest rate reduction;

Title II, providing for borrower relief by forbearance and restructuring efforts;

Title III, providing for specific borrower rights;

Titles IV through VII address the functioning of System institutions and their relationship with the regulator and with each other, as well as addressing the need for creation of a reserve fund—and I will refer to that to a further extent in a little while—and this reserve fund can be used by the regulator to assist ailing System entities. In these titles, we believe that we will effectively solve the problems that are now tying the System up in litigation across the country, thus ending the basis for the litigation. So we offer that solution.

Finally, in titles VIII, IX and X, we look beyond the present need of borrowers, to the future requirements of this System, to ensure that it continues to be an operation that is truly cooperative and with a genuine sense of local control. We also provide for a cooling off period in the respect that mergers have been provided for in other ways, and we require also that a reporting be given to each and every institution by the Funding Corporation, of the direction of their stewardship and an analysis of the expenses that they have incurred in the past year. We believe that this ought to be the property of every single association as well as you gentlemen in the Congress and elsewhere.

Collectively, these provisions address, we believe, the issues of greatest concern to the borrowers, to the banking institutions themselves, and to the regulator. These provisions work together to produce a result greater than if any one of them were singled out, so we are saying cooperatively they work together to solve not one but all of our problems.

Overall, we believe we address the relevant needs and do so in a way that leaves a permanent infrastructure in place, with correct incentives for those participating in the System to act responsibly in the future. Our provisions represent a intense effort of self-help—and let me underscore that—of self-help by those participating in the System, to utilize its own resources and only then will ask for Government guarantees or for a direct Treasury infusion of capital, even then in a limited way and only for a period of a short duration.

Before going into more detail about the things we believe that Congress should do in its new farm credit legislation, let me first point out several points of the Farm Credit Act that in our view do not need fixing.

We must not abandon the principle that borrowers must hold meaningful amounts of stock in the System and we must not accept the idea that token stock requirements are acceptable. Stock indicates ownership. Without stock ownership, centralization inevitably will take place.

We do not need to abandon joint and several liability. We do not need to down-size district banks.

Now, let me turn to a brief discussion of each title of our bill. Title I, first of all—and you will find that, if you care to look at it, on page 1—Title I mandates an across-the-board interest rate reduction of five percentage points on all Farm Credit System loans for a period of 2 years. Two points are funded by the Treasury. One point is funded by the System. Two points are funded by the application of up to 50 percent of the borrower's stock as a credit against interest otherwise due. This is an across-the-board program because the struggling borrower should not have to become delinquent before he becomes eligible for help.

Title II sets up a program for borrower relief through forbearance and restructuring. The House Government Operations Committee, chaired by Jack Brooks, found in the year 1986, and I quote from his report, that "the System tended to use foreclosure on delinquent loans as a first resort, rather than attempting to work out problems before foreclosure." That is found in the House Report 99-566, April 29, 1986, and it is entitled "Farm Credit Administration's Role in the System's Crisis."

Under our bill, institutions will be required to consider the options presented to determine if some forbearance or restructuring would not be in the best interest of the borrower and to offer reasonable protection at the same time to the institution. Loan writedowns are not mandated, because we believe that they offer an incentive to delinquency instead of an encouragement to success, but these can be considered by each and every borrower.

If a borrower cannot make it, however, we offer a leaseback buyback program. The institution in that fashion takes title to loan collateral, leases it back to the borrower if he is viable, and allows repurchase within 10 years at a price to be agreed upon at that time. Acquired property under this program can be used as bond collateral—and let me say as an aside that this takes land off of the market and it enables that district or that bank not to become immediately land poor. He puts this into this sort of an operation where he gets the immediate cash that he needs and it removes the probability of decreasing or depressing land prices, so this allows them for that property that has been reacquired to be used as bond collateral.

The next thing that we find is that title III directs—and title III is found on page 8—that the borrowers cannot be required to provide additional collateral on loans that are current, or be foreclosed on for failing to do so. This title also affirms that borrowers have a right under the Farm Credit Act to sue System institutions and the Farm Credit Administration for abuses. I will refer more to that later.

Title IV, on page 10, mandates the uniform use of regulatory accounting. The extraordinary short-term costs that the System is suffering due to huge loan loss reserves and high-cost debt are actually gobbling up our earnings. This title requires that these costs be amortized over 20 years.

Title V, on page 11, removes several very great threats to local control in the System. It provides that we sunset the Farm Credit System Capital Corporation, and we recognize that this is the System that has been used to promote centralization or a super bank. It has never done the job of financial assistance that Congress intended it to do and created it to do. It also terminates other service organizations, with their 400-plus employees and huge budgets, including the "central entity" Farm Credit Corporation of America. However, the Federal Farm Credit Funding Corporation is left in place.

Title VI, on page 13, accelerates current law and empowers the Farm Credit Reserve Fund to take the place of the Capital Corporation in providing financial assistance to troubled institutions.

The Reserve's initial funding is through a one-time issuance by all banks of an uncollateralized obligation in the amount of $1.5 billion, guaranteed and only guaranteed by the Treasury. This provision allows the System to finance the bulk of its assistance operations without exacerbating the System's present collateral difficulties.

The Reserve will be maintained perpetually at a sound operational level by payments into that Reserve of up to 1 percent of the proceeds of each bond that is sold by any of the System banks. The Reserve shall ensure, first, that the institutions can continue to provide farm credit services in their territories. The Reserve will also be responsible for guaranteeing borrower stock for a 5-year period while borrower confidence in the System is being reestablished.

Title VII, on page 17, terminates the present interbank loss sharing agreements in the System because they would conflict with the proper operation of the Reserve.

Title VIII, on page 18, provides a new right of election in the stockholders of a System bank to have a separate board of directors for that bank if they so choose. We believe that the stockholders of any bank should have the right to have a board that is fully accountable to them.

Title IX, on page 20, requires a cool-off period following a vote of association merger, during which association stockholders can petition for a meeting to reconsider. This provision is designed to insure that mergers only be executed with stockholders being fully and truthfully informed and in agreement, and we underscore the word "truthfully."

We must not forget that the Government Operations Committee, chaired by Jack Brooks, that I referred to a moment ago, formally reported to Congress last year that "FCA supervised the merger election process in a manner which allowed district bank officials to use misstatement of facts"—in Texas we use the word "lies" there, but this is the language that was found in the report—"misstatement of facts and threats of coercion to persuade stockholders to approve district wide mergers." That committee recommended to the Chairman of the FCA, "The Chairman monitor closely any future merger elections to insure that members of associations will have adequate and accurate information well in advance of the date for balloting."

Title X, on page 21, requires the Federal Farm Credit Banks Funding Corporation to make annual written reports to System institutions detailing its operations.

Enactment of this bill, Mr. Chairman, will help the farmer-borrowers, it will help the System's banking institutions, and it will give the regulator all of the authority as well as the responsibility it needs while responding to the constituent pleas from home that you and others are hearing as Members of Congress.

We urge you to enact the provisions we are suggesting. This concludes my formal testimony and I will be pleased to answer any questions, Mr. Chairman, that you and the others might have.

Thank you.

Senator Boren. Thank you very much, Mr. Holman, and I appreciate the detailed recommendations which you have included here and I think there are some very fine recommendations included among them.

Let me ask just a couple of questions, and then we are going to have to press on. You talk about borrowers needing to continue to hold meaningful amounts of stock—and I noted also in your statement that you talk about guarantees only for a transition period, I believe you said 5 years is your recommendation.

Mr. HOLMAN. Yes, sir.

Senator BOREN. By meaningful amounts, do you mean more or less in the same manner that they now hold?

Mr. HOLMAN. Absolutely, not less.

Senator BOREN. Not less.

Mr. HOLMAN. Yes, sir.

Senator BOREN. I think you have a proposal also for a lease-back buy-back program.

Mr. HOLMAN. Yes, sir.

Senator BOREN. On what basis would the farmer repurchase his land, would the cost be on the then current market value, the loss value, agricultural value or what?

Mr. HOLMAN. We made two or three provisions. Whatever the current position of that farmer is if he were to lend and could not pay, he would approach the lending institution, not some entity out in Denver but his local area people who know him, and they then would immediately take title to that property. After having taken title to that property, if he were a viable operator, they would lease it back to him and immediately issue a bond on its then current worth. If it were half what it originally was, they would issue a bond in the exact amount of its current worth.

The cost of the bond would be paid by the lease that was received from the use of the land. At the end of some particular period of time, not to exceed 10 years, that person would be able to buy that land back at whatever its then current worth was.

Senator BOREN. At the end of the 10-year period.

Mr. HOLMAN. At the end of the 10-year period or he could do so early, but in no case would he pay more than what the original amount was plus any interest that might have accrued over that period of time.

Senator BOREN. What about the merger of unlike associations?

Mr. HOLMAN. We strongly disagree with that, Mr. Chairman.

Senator BOREN. You disagree with that?

Mr. HOLMAN. Yes, sir.

Senator BOREN. Why do you disagree with that?

Mr. HOLMAN. Well, it was mentioned this morning that this would be a better thing because you would have all of your eggs in one basket. We think that just the reverse of that is true. We would rather have two bankers to talk with, than one, and if you are ever cut off from one source you would be cut off from all sources if that were true. But the vast difference, as I believe you pointed out in your questions, indicated that there is a vast difference between land loans and those on plant loans. It is very unwise, in our opinion, and our stockholders are unalterably opposed to that.

Senator BOREN. Thank you very much. We appreciate your testimony and your thoughts and you certainly are a student, a very well informed student of this whole System and your ideas will be very helpful to us.

Mr. HOLMAN. Thank you.

Senator BOREN. Mr. Biery, we would be happy to have your testimony at this time.

Mr. BIERY. Thank you, sir. I first of all would like to express my gratitude for your allowing us to be here to testify today. Accompanying me to the stand is Joe Leiser, who is our president and chief executive officer of the Northern Ohio PCA, and John Deal, our attorney.

Senator BOREN. We are glad to have you.

STATEMENT OF DEAN BIERY, DIRECTOR, PRODUCTION CREDIT ASSOCIATION OF NORTHERN OHIO, ACCOMPANIED BY JOE LEISER AND JOHN DEAL

Mr. BIERY. The Northern Ohio PCA serves six counties in north-central Ohio. We are about 53 years old now. I am Dean Biery, vice chairman of the board, and have served there for about 11 years. I have a 125-acre grain and hog farm there. We specialize in purebred Durocs and we sell seed stock locally, statewide, nationally, and we have developed a pretty good export business and in our way are helping the balance of payments problem we have here in our Nation.

When I started, I was an agricultural extension agent and I didn't have a lot of funds to start farming. I was able to secure an operating and equipment loan from PCA and I have been with them now since 1965 and have found them a very dependable source of funding for my operating and intermediate term investments. I have a lot of loyalty to the PCA. In fact, my son is now a borrower.

My wife and I and four children run the operation and I guess we could say it is indeed a family-type farm, with family labor.

Of course, I have paid a lot of interest over the years and will continue to as long as it is my PCA, but I do not know how much longer it will be my PCA. Twice in the last 2 years, Congress has enacted hastily drafted farm credit legislation. While sincere in motive, in both cases the legislation in some ways only made matters worse for us.

This may be our last chance to save the System. Our PCA, along with four others I am speaking for today, Central Kentucky; Chattanooga, Tennessee; Jackson Purchase, Kentucky; and Marion, Ohio, filed one of the first lawsuits challenging the 1985 legislation and specifically the Capital Corporation and their regulations and transfer of funds. Numerous others also filed lawsuits.

Together, these lawsuits have allowed our PCA and many other Farm Credit System institutions to continue to operate in the interest of our stockholders. Some of the things you have been told about why we filed suit are simply not true.

For example, in his testimony on February 26, FCCA Chairman Brent Beesley said that the lawsuits attacked the FCA's regulations, not the notion of sharing capital. That is not true. He also proposed a plan to settle the litigation. His proposal will not work.

The simple fact is Brent Beesley does not speak for us, never has and never will. If we had our way, the FCCA would be abolished.

Until now, nobody has spoken for us but ourselves and our lawyers. We were unable to get on the witness list when the 1985 legislation was being considered. However, our local Congressman, Mr. Mike Oxley, was able to get some testimony of ours placed in the Congressional Record. It is there on December 12, 1985, and it states there our position regarding the Capital Corporation and how detrimental we thought it would be to us.

The only place we have been heard until now is in court. Mr. Chairman, we are grateful at long last to be able to present our view to Congress. We do not claim to speak for others, but we think that if other PCA's were asked, they would agree with us.

In his recent testimony before the House Agriculture Subcommittee on Conservation, Credit and Rural Development, FCA Director Jim R. Billington outlined what is at stake. Within the System, about 80 percent of the unallocated surplus is controlled by the PCAs. Taking this surplus would result in increased interest costs to the PCA stockholders of $120 million per year, and on a percentage basis for our 1,700 or so members in six counties, it would amount to about three-fourths of a percent increase interest rate if our PCA had to pay the proposed assessment of $5 million.

That effect on farmers' borrowing costs is only part of the reason our PCAs have filed their lawsuit. More important to them is that if they do not win this fight, the rest of their PCAs net worth is subject to taking at the whim of Congress. Our PCA will continue to fight for our constitutional rights until the Capital Corporation is abolished.

The Farm Credit System's problems were not caused by the PCAs, and taking our money will not solve the problems. Until 1977, the long-term borrowing of each farm credit bank was done separately. However, present financing arrangements involve securities sold jointly through the Funding Corporation. This has resulted in two problems.

First, the Farm Credit Bank is unable to control its risk because it has no control over the credit decisions of its sister banks. Second, the Funding Corporation has issued huge amounts of high coupon long-term noncallable notes. Currently, the Farm credit banks' average cost of funds is about 9.5 percent, that is prime plus 2.

Because our PCA is very strong financially, we have been able to borrow from the FICB and lend money at competitive rates. Based upon our income in 1986, we will make a patronage refund of $524,000 to our borrowers, half in cash and half in Class A stock, representing almost 9 percent of the interest they paid in 1986. At this point in time, our interest rate is 8.5 percent for our best loans, and we have people coming to us inquiring about financing.

You might be interested in knowing why we had so much excess income in 1986. It was because of the fact that the FCA would not let us lower our interest rates because of capital directive, No. 1. When the cost of our money went down, our earnings became excessive. Our view of earnings is that we would like to earn sufficiently to run our operations, but we would like to keep our interest rates sufficiently low so that our borrowers who are in a lower tax bracket than our PCA can realize the savings. This results in a savings to the farmers in our six-county area.

We intend to keep our borrowers with us and to preserve their investments and preserving their investment does not include giving their money to the Capital Corporation. As the problems of the farm credit banks grew, others began to covet our net worth.

In 1985, the FCA adopted a regulation to authorize it to transfer assets among the various System entities. This posed a threat to the healthy PCA's and the farmers who owned them. Immediately after the adoption of the transfer of assets regulation, the spread between the yield on Farm Credit System securities and those on U.S. Treasuries widened. Some farmers began to pull out of the System to avoid having their investments taken. Some PCA's began to consider dissolution for the same reason. We and others filed lawsuits challenging the regulation.

In December 1985, with the congressional legislation, it was a mixed blessing for us. At that time, we were being coerced, threatened, manipulated, and maneuvered into joining a one district PCA in our district. We were trying to avoid this and they were threatening us with overchartering. In other words, they would just put the big PCA right over the top of us and put us out of business. Then they said that we as directors would be liable for the losses in our PCA and so on. We will be eternally grateful for the 1985 legislation because it forbid that, overchartering. On the other hand, it created the Capital Corporation.

Senator **Boren**. I understand.

Mr. **Biery**. So here we are. This was a shock to our borrower confidence. We have in our office a certificate of complete ownership received from the Government showing that our farmers own the PCA and that it was paid off in 1949, yet the 1985 act authorized the Farm Credit System Capital Corporation to take assets of some of the healthy farm credit institutions and transfer them to other units.

We look upon that as confiscation of private property. Shortly after the Capital Corporation regulations were adopted, lawyers for a number of healthy PCA's, including ours, met in Kansas City to plan a strategy to protect the PCAs from being assessed by the Capital Corporation or required to contribute to it. Our lawsuit and several others were filed.

Our borrowers stayed with us because they have been told for 50 years that they own the PCA and they believe we will win in court.

Without financial assistance, six FLBs would have shown an impairment of their capital by the end of the third quarter of 1986. Last October, Congress responded with the Farm Credit Amendments of 1986, which allows "regulatory accounting principles" to paper over the condition of the sick FLBs and delay the need for Federal assistance.

According to the System's third quarter 1986 report, the 1986 legislation may actually accelerate deficiencies in the collateral that backs Farm Credit System securities. This is only a band-aid and not a solution. Mr. Chairman, you have recognized that neither the 1985 nor the 1986 legislation solves that problem, and we are grateful for that.

Forgotten in both the 1985 and 1986 legislation were the System's good customers, the creditworthy farmers and ranchers who own stock in PCAs and FLBA's and who have paid their debts and will continue to do so. The farm credit banks' future revenue depends upon retaining these creditworthy farmers and ranchers. Instead, the 1985 legislation is driving them away.

The result is a loss of loan volume, turning into a downward spiral that will result in the collapse of the System if we do not change course. Farmers paid down about $8 billion in loans in the first three quarters of 1986 alone. According to Mr. Billington, the PCA's have lost 110,000 borrowers since 1984. Here is how we would stop the borrower flight and save the System.

First, the Capital Corporation must be abolished. When commercial banks fail, their assets are usually sold to healthy banks. Assets flow from poor managers to good managers. The Capital Corporation is designed to do the opposite, to take assets from good managers and put them in the hands of those who have failed. Also, the Capital Corporation has assumed authority over matters it has no business being involved in. The Capital Corporation even wanted access to our PCA's records and the services of our personnel.

Second, our constitutional rights must be clearly recognized in the legislative history that will accompany the bill that you draft. Congress must make it clear that in the future no farmer or rancher need fear having his property taken to benefit another.

Third, we need to pare the layers of bureaucracy that have been created, especially the FCCA. We do not need three sets of auditors, one will do. Our auditing bill has been atrocious. We have been audited three times. We get audited by an outside auditor, we get audited by our bank, we get audited by the FCA and they all present us a bill and the out-of-pocket costs, Senator, is one thing, but secondly, the upheaval and the turmoil that it causes in our offices is getting unbearable and some of our best employees are getting to the point they have had enough. We need to streamline this in some way or other.

We need a decentralized system. The forced consolidations have greatly increased costs in some parts of the country. We have stayed independent and we are proud of the fact that we are operating on a rate of about $1.50 per hundred of funds loaned out, a 0.79 spread over the cost of our money.

Fourth, institutions within the System should be allowed to succeed or fail on their own merits. If there are viable institutions that need short-term assistance, the Government should provide it, but only if the Government can eventually get its money back. We do not want the Government to own the System and we do not want handouts. This assistance should be administered by the FCA under the supervision of Congress, not by the Capital Corporation or the FCCA, which have their own axes to grind.

Help has been extended in the past by the Federal Government and later repaid. Our little PCA in 1933 was the last to receive assistance. I think it was $120,000, and we tied for second in December 1949 to pay it off. In fact, the membership there had a special fund drive from 1946 to 1949 to sell Class A stock to pay the Government back.

Such aid would represent another expense at a time when we need to contain Government spending, but limited aid now is likely to be far less expensive in the long run than continuing on the present course. Congress needs to keep the good borrowers in the System. These people are the System's only source of revenue.

I would be happy to answer your questions.

Senator BOREN. I appreciate your statement very much. I might say that I was the author of the overchartering amendment which you referred to in your statement and I feel very strongly about that. I have never seen the kind of actions that were utilized to threaten and cajole people into some of these mergers. We even had a situation in our State—I think I am going to testify in a court case on it in a couple of weeks—where the entire board was removed for cause in theory by the Wichita district because they dare to appear at a congressional hearing and give their point of view about a new building, an airplane and other costs that were going on to their own elected Members of Congress. They were all removed right after that for exercising their free speech rights.

Mr. BIERY. We were threatened with removal, too.

Senator BOREN. We have had incredible misuse of power within the System and I can assure you that I am going to look at whatever we do with a fine-tooth comb to make sure we do not leave room for that kind of action in the future.

You talk about loss sharing. Is there any way that you believe the capital assessment regulations could be rewritten in a manner that would alleviate your concern? Do you see any way that they could be rewritten to do that?

Mr. BIERY. You see, if we would be assessed, we would be in the same area as we were before. There is a formula that deals with the amount of money we can borrow from our bank called the direct loan limit formula. When we exceed the limit we are in default. When our cash-flow is affected by assessments, we are in danger of exceeding the limit. For instance, in 1985 we were required to invest $600,000 of stock in the district bank because our usage was at a higher percent than some of the other PCA's. We were also asked to send an additional $350,000 in loss sharing to other associations in the district because we are part of a loss sharing agreement. Sir, our members cannot afford any more assessments of any kind.

Senator BOREN. Did you sign the loss sharing agreement?

Mr. BIERY. Yes, we signed and we paid. We are not uncompassionate. We have paid what we signed to pay for in loss sharing. In fact, in 1985 we had to come up with $1 million out of our cash-flow to meet two assessments and it put us in a position at that time of needing what they call special credit, and your direct loan limit is determined by your loan portfolio credit's quality.

So then they told us that since we needed special credit they would not sign our request for special credit unless we agreed to go in with the one big association. Those are the kinds of tactics. So we look very dimly on any kind of a cash outflow, sir, from our PCA because of what it does, and a $5 million assessment would be disastrous.

Senator BOREN. What about permitting System institutions and associations to establish a voluntary loss sharing fund that would provide loss sharing assistance to those that participated or contributed to this kind of a fund? How would you feel about that?

Mr. **Biery**. Personally, I would like to see—and quite frankly, I have not discussed it with these gentlemen, so they might take a different point of view—personally, I would like to see a similar insurance to what FDIC has, very similar to what Mr. Holman was talking about here.

Senator **Boren**. Do you gentlemen feel the same way?

Mr. **Biery**. It would be exceedingly less than $5 million, I will guarantee you.

Mr. **Deal**. I think, Senator, there is always the potential that if misused such a fund could have the same sort of abuse as we see in the Capital Corporation.

Senator, I was employed for approximately 9 years by the FDIC and I can see a lot of good that has been done over the last 50 years by the FDIC. If done properly, it could be very helpful.

Senator **Boren**. And that would be a better approach, you think, than the kind of approach we are using now?

Mr. **Deal**. I think, Senator, one thing to keep in mind about the FDIC, the FDIC is a Federal agency and its members are appointed by the President, Congress has oversight and you are not dealing with a quasi-private entity located out in the outskirts of this country where Congress cannot keep an eye on it, and the people in the FDIC report regularly to Congress and they do not really have their own axes to grind.

Senator **Boren**. Some are the largest employers in my State now. [Laughter.]

I appreciate your comments very much. They are very helpful and I am glad that you have had an opportunity to state your points of view and I assure you we will keep them in mind as we work on this legislation.

Mr. **Biery**. Thank you for having us.

Senator **Boren**. Thank you very much, all four of you.

Could I ask Mr. Dean now, John C. Dean, chairman of the Agriculture-Rural Committee of the Independent Bankers Association of America. I understand that Mr. Dickey was to have been with you and had a death in the family and is not able to be here. Would you please express my regrets to him. He is a long-time friend of mine and I am sorry that he is not able to join you.

And Mr. Ranger, would you like to come up at this time, too, Robert Ranger, chairman of the American Bankers Association Agricultural Bankers Division, senior vice president, Norstar Bank of Upstate New York.

Mr. Dean, you are from Glenwood, Iowa. We are very happy to have both of you and, Mr. Dean, we will begin with your testimony.

STATEMENT OF JOHN C. DEAN, PRESIDENT, GLENWOOD STATE BANK, GLENWOOD, IA AND CHAIRMAN, AGRICULTURE-RURAL COMMITTEE, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. **Dean**. Thank you very much, Chairman Boren. I am John Dean and I am with Glenwood State Bank, Glenwood, Iowa, and I am chairman of the Agriculture-Rural Committee of the Independent Bankers Association of America.

As you stated, Jack Dickey, who is vice chairman of our Agriculture-Rural Committee and also president of the National Bank of Thomas, Oklahoma, was to testify but he did have a death in his family and hopefully I can cover for him.

I am just going to try to speak more or less from notes. I will cover what is in my testimony, but I see no point in trying to read the testimony to you at this time.

Senator **Boren**. That will be helpful and we will put all of the testimony in full in the record.[1]

Mr. **Dean**. Thank you.

We appreciate the opportunity to be here and present this testimony to you. As you develop this farm credit legislation, I hope you agree with us that what we need is not what is good for the bank, not what is good for the Farm Credit System, and not what is good for the insurance company, but what is going to be good for the farmers and ranchers. That has got to be the primary thrust of the whole thing.

Resolving the present problems of the Farm Credit System is, of course, the primary responsibility of the borrower, of the farm credit institutions, the regulators, and of course the administration and Congress.

I would like to go a little further than that, if I can, and speak to another point that was discussed almost by every speaker this morning, and that is the need for a secondary farm market out there on the thing.

Jack Dickey's bank in western Oklahoma is just as committed to the family farm and agriculture as any other lender. Our bank is. Any action taken by this committee or by the legislation should deal equally with the farm customers or the Farm Credit System and the farm customers of all commercial banks.

We are convinced that a vital part of any legislation should be the inclusion of a farmers' secondary market. Such a secondary market would be of utmost advantage to the farmers. Let me explain.

The American Bankers Association, the insurance companies, the Farm Credit System, and the Independent Bankers Association have all spent almost a year working on a secondary market. And as you heard in the testimony this morning, I think the Farm Bureau, the pork producers, they all indicated a real need out there for a secondary market.

This market could and would do several things. It would help the farmer get long-term fixed-rate credit. It would be practically risk free to the U.S. Treasury. It would be equally fair to all lenders. It would have market discipline. It would help keep the price of land, farm land from declining further, which would be of great help to the Farm Credit System. It would be financially profitable to the Farm Credit System.

All of these things would help reduce the Federal assistance necessary from the Federal Government to the Farm Credit System. And it would also have a qualification in there that if you are familiar in our area, we do not have a lot of big farmers. A lot of our farmers need a small amount of money.

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[1] See p. 515 for the prepared statement of Mr. Dean.

In the past, it has been hard for a lender to borrow long-term on a small amount. This would have a rule that you could not discriminate because of size, as long as the request for a loan was over $50,000. Now, I do not want to lead you to believe that there is complete agreement with every one of us on how this secondary market should be drawn or should work.

In substance we agree. This would work in sort of a—if I could explain in sort of a simple way, it sounds complicated when we get into it, Senator, but it is not nearly as complicated as the IRS W-4s which we all received a short time ago. [Laughter.]

This secondary market would have originators. The originators would originate the loan. That could be the Farm Credit System, it could be commercial banks, it could be anyone. The farmer would then come into the bank, to the originator and sit down and talk about what he needed. The originator would look it over and decide if it qualified.

Now, there are two qualifications that have been agreed on, it should be a percentage of the fair market value, 65 percent is what has been talked about quite a little bit, and that that piece of ground would cash-flow. Now, both of those things would be very important to make a sound loan.

The originator would then explain that the originator would do the paperwork on this loan, he would service it, the farmer or rancher would be dealing with this originator. He would not be dealing with some lender in Chicago or New York or any place else, he would be dealing right there at home. The originator would make the loan, he would collect the payments. He would be servicing the loan.

The originator would then take the loan to a pooler. Now, this pooler again could be the Farm Credit System, it could be a large bank in Oklahoma, it could be an insurance company, it could be almost anyone that was qualified to set up a pool. Now, the pooler is going to make a fee on this by putting it together. Now, that fee, of course, would go to whoever made it up. If it was the Farm Credit System, the Farm Credit System would make that fee. If it was an insurance company, they would make the fee.

The pooler then would determine if the loan would meet the underwriting standards again, and then the crucial or the market discipline part of this program is a 10 percent reserve. The originator and the pool between them would have to put up 10 percent. I am sure you understand it, but let me explain it a little bit, if I may.

In our bank, suppose we were going to come up with three loans of $100,000 that we were going to sell under this pool. We would then have to put up, either the pooler or us or a combination of us, $30,000, 10 percent of those loans as a safety net. That money would be put in Government bonds and would set up there in the pool, the pooler would control it, it would be put in Government bonds. We would earn on it, Government bond interest, but it would be there to take up the slack if one of our loans go bad.

Now, if one of our loans goes bad and it took the whole $30,000, my $30,000 is gone. If another one of those loans that I put in there takes another $10,000, it reaches the whole pool. So you have the pooling effect, first chewing up the money of the originator and then going to the whole pool, and that will help keep the pooler honest on the thing. The pooler then would determine if everything was in order and he would take it to an enhancer.

There have been several bills introduced. Just today, Senator Exon and Senator Grassley introduced a bipartisan bill along this line that would follow this arrangement. That bill calls upon the Farm Credit System to put the enhancement stamp on it. Now, there would be a fee for that. The fee would be no more than half a percent, but on a $10 million pool, half a percent is $50,000, I think, and that is quite a little money for putting a stamp on it. That money then would be set aside as an FDIC type, as Dr. Harl was talking about this morning. It would be earnings, it would be there to take up losses or earnings for whoever put the enhancer on it. It should work.

The pooler then, after the pool was all done, he takes it, the whole deal takes it to Wall Street and they buy it. Now, the people know a lot more about Wall Street than I do, say with that enhancement on there, that is salable and the enhancement would be a quasi Government enhancer and that will bring the rate down so this farmer and rancher will be able to get a 20 or 25 year loan to buy new land at a fixed rate and at a low fixed rate.

It looks to me like it would go. Now, to carry it a little bit further—and I hate to get into too much detail, but I heard the Senator this morning from Idaho talk about his land had gone down a third. Ours has gone down two-thirds in Iowa. But in an example, in our county in southwestern Iowa, which is strictly a rural county, our land hit about $2,500 an acre. That land today would sell some place in the neighborhood of $800.

Now, if you make a 65 percent loan of that, that would be $520 that you would loan on that land that used to be selling for $2,500. Now, bear in mind that we are going to take 10 percent more to put some place, so that is $52 to protect that. Now we are down to a loan of around $470. Now, that $470 loan on that land is approximately 19 percent of the high of the land in Iowa. In Iowa, in the 1920's and 1930's, our land got to $500 an acre, it went down to $100 an acre, good land. That is 20 percent. So this would protect it more than the break was in the Great Depression when corn was 10 cents a bushel. So we think the risk to the enhancer would be very, very remote, and you put that on top of the fact that there is a pooler, we just think that it would really fly that way.

There are quite a few advantages. One, there would be more money available for land purchase. That would, of course, help the farmer that wants to sell a farm and help the farmers that want to buy a farm. It would hold up the price of land. That would be very beneficial for the Farm Credit System. The fees to the enhancer and to the pooler would be a profit making incentive for the Farm Credit System if they were the enhancer.

Most important, it gives the farmer a way to get long-term fixed rate and, as we all know, farming is a long-term business. They do not make a lot of money. The story in our area was that if you are a farmer, "he always lives poor and dies rich," and that is about right because he never has any money.

We just think this thing would really fly. I think that when we were going over this this morning, I tried to put down on paper the disadvantages to it, to the bank, to the Farm Credit System, to the insurance companies, to the Treasury, and I could not think of any. There seems to be pretty general agreement that this will work.

Now, there is a lot of detail that has to be worked out in the bill and there is the bill that was introduced by Senators Exon and Grassley today, maybe there are some places that could be cleaned up, but we think that would go a long ways toward helping the farm situation in the future. As Professor Harl said this morning, there are two problems, there is the present problem and there is the future problem, and we think this will work, we think it would not be expensive for anyone, it would give competition out there to everyone, it would be many sources for a farmer to get loans.

I know in your home town or in Washington, DC, if there was nobody loaning on houses today, the house market would be pretty tough, and that is basically what we have got out in agriculture.

Well, thank you very much for having us and if I can answer any questions, I would be glad to.

Senator BOREN. Well, I think I will let the rest of the panel testify and then I will address questions back to all of you.

Now, I understand, Mr. Ranger, are you testifying for Mr. Lindholm also?

Mr. RANGER. No, Mr. Lindholm is with me today.

Senator BOREN. Why do you not come up and join us, and also Mr. Ball as well, I believe, right?

Mr. Ranger, do you want to go ahead?

STATEMENT OF ROBERT W. RANGER, CHAIRMAN, AGRICULTURAL BANKERS DIVISION, AMERICAN BANKERS ASSOCIATION, ACCOMPANIED BY PAUL E. LINDHOLM

Mr. RANGER. Mr. Chairman, we certainly appreciate the opportunity to be here today. My name is Bob Ranger and I am with Norstar Bank of upstate New York. Also, at the present time I have the privilege of being the division chairman of the Ag Bankers Division of the American Bankers Association.[1]

I might like to add also that I have had the privilege of serving farmers in upstate New York through a commercial bank for the last 28 years. Also with me today is Paul Lindholm, vice chairman of our Ag Bankers Division.

We would like to very briefly cover three subjects which we feel are very important. One is to bring you up and reiterate again some of the problems with agricultural banks throughout the country, our concerns about the Farm Credit System, and also Paul Lindholm will cover our support of the secondary market.

It does not need any reemphasis, but there is a serious farm problem throughout the country. The problem not only is affecting farmers but also commercial banks and all the input suppliers associated with agriculture and the banking community.

To put some numbers in proper perspective, recent Federal Reserve System statistics dated December 1986 indicate that the

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[1] See p. 516 for the joint prepared statement of Mr. Ranger and Mr. Lindholm.

Farm Credit System has approximately $48 billion in loans outstanding to farmers. To show you the importance of commercial banks, those same statistics indicated that commercial banks had $43.9 billion in loans to farmers. I suspect that at the present time commercial banks may be the largest supplier of credit to farmers.

Obviously, the fundamental problem in agriculture is farm income resulting in significant decline in asset values. This affects the banking industry in three areas, increased delinquencies, increase in nonaccruals, and also in the earnings capacity of the banks.

Our point is that even with these problems in the rural areas, commercial banks still have a large stake in agricultural finance and are still supporting agriculture.

I would like to make some comments concerning the Farm Credit System and again it does not need the reemphasis of the difficulties faced by the System.

We would like to just briefly mention five areas that cause us some concern, that we think should be looked at very closely in any additional assistance given to the Farm Credit System. Those five areas are the regulatory structure, risk capital, loan to appraised value of real estate, pricing policies, and proposals to centralize the structure.

First, I would like to make a couple of comments regarding the regulator. We would like to compliment all of those who would propose and implement a strong independent regulator. We think that this is extremely important. Frequent examinations and careful regulatory standards are extremely necessary to insure the safety and soundness of any lending institution.

We also strongly support an independent regulator to help continue to protect the safety and soundness of the System. However, to be an effective regulator, we feel that there must be risk capital in the System. In any organization, corporate organization, it is necessary to have a sound capital structure that is derived through earnings and proper operation of that institution.

I believe our statistics are correct, that of the capital structure today, $1.5 billion is in the form of surplus, and $4.1 billion in the form of participation certificates or stock, stock ownership. If the stock is not at risk, the System is significantly under-capitalized, then the Federal Treasury is very much at risk.

In addition, during the past 2 years the System has pursued risky lending practices, particularly in the loan to value relationship of lending on real estate. In 1971, a loan to value limits were raised from 65 to 85 percent, and it is our belief that part of the problem that the System has today is caused by that liberal lending philosophy.

Pricing is another practice which should not reoccur in the future. The use of average cost of pricing versus marginal cost pricing, in essence the System has given away its capital to gain market share. Decentralization is a concept that is strongly supported by the ABA. We are strongly in favor of that. However, one of the concepts that might want to be considered would be the possibility of outside directors. Outside directors in banking circles has proved very effective, to have someone from an arm's length to look at the operation of the individual institution.

Mr. Chairman, those are my brief remarks. At this time I would like to turn it over to Paul to cover the secondary market.

Thank you.

Senator BOREN. Mr. Lindholm.

Mr. LINDHOLM. Thank you.

As you already know, the American Bankers Association has a strong commitment to the secondary market for agricultural real estate loans, and that is a high priority with us. We believe that, properly structured, it will be a benefit to the farmers and to the banks in the Farm Credit System.

We are pleased to be working with the life insurance companies, the Independent Bankers Association, the Farm Credit System in this effort, and as has been mentioned, there are a lot of benefits to this System. Banks would gain a new product actually to the benefit of the farmer, because banks are now limited due to the lack of a long-term source of funds for the secondary market. Banks would also be able to diversify risk.

Insurance companies and other poolers of mortgages gain a liquid market in securities backed by firm mortgages, thus inducing them to remain involved in agriculture. I think we see a lack of financial involvement in agriculture in our area. We have had some of our major holding companies become disenchanted with agriculture. We need to create an environment where we can have good participation in agricultural lending and farmers would have the big benefit of gaining fixed rate mortgages at competitive rates.

So, as you see, we are very heavily involved in this project and we look forward to working with the committee. In conclusion, I am sure we are all well aware of the difficulties in the ag economy. We want to remind the committee and the Congress that they do not adapt policies which would unduly advantage one sector over another. Rather, we would urge you to seek to create a response that will help us solve some of these problems by building a market discipline into all of these institutions. A major reason for our support of the secondary market is that it contributes vitally to competition and competition will be good for everyone.

The farmers need several providers of long-term agricultural real estate credit. In order to have this workable long-term financing we need risk capital, a strong regulator, local control, and an appropriate environment to make all these happen.

Mr. Chairman, the ABA, the American Bankers, looks forward to continue to work with you and the members of your committee.

Thank you.

Senator BOREN. Thank you very much.

Mr. Ball, any comments you would like to add?

STATEMENT OF JOHN W. BALL, VICE PRESIDENT, AGRICULTURAL INVESTMENTS, MONY FINANCIAL SERVICES, INC., REPRESENTING AMERICAN COUNCIL OF LIFE INSURANCE

Mr. BALL. Yes. Mr. Chairman, I am John W. Ball, vice president, agricultural investments, MONY Financial Services, Inc. The following testimony is submitted on behalf of the American Council of

Life Insurance. The ACLI is a trade association with a membership of 629 life insurance companies.[1]

The life insurance industry has long been a provider of mortgage financing to agriculture. Many of the companies providing capital to agriculture today have been doing so for more than 100 years. The life insurance industry currently has approximately $11 billion in mortgages secured by farm land.

Farm mortgages make a positive contribution to a well balanced investment portfolio. It is our desire to continue that investment experience and to provide capital to agriculture upon competitive terms.

Investment in American agriculture by commercial lenders has always provided much needed benefits for farm and ranch borrowers.

The prolonged, on-going agricultural recession has created severe financial dislocations for many farmers. All lenders serving them have also been adversely affected. We believe it is clear that farming and ranching are undergoing fundamental change.

The life insurance industry believes strongly in preserving the integrity of the Farm Credit System. We want the System to maintain its role as a vital and reliable credit provider for farmers and as a strong competitor in the farm mortgage credit marketplace. Farmers and lenders alike benefit from a healthy competitive environment in the agricultural mortgage lending sector.

The issue before you today is a matter of utmost public policy concern. Illiquidity of farm mortgages puts long-term commercial real estate lenders, such as banks and life insurance companies, at a disadvantage in obtaining funds for mortgage lending. In contrast, the Farm Credit System's "agency status" provides it with ready access to national capital markets.

Changes within the financial systems that serve agriculture have prompted the ACLI to ask what structural changes do our members, as farm mortgage lenders, have to do to make to continue serving agriculture effectively in the future. And by the future, we do not mean the next 60 to 600 days, but into the 21st Century.

Taking this longer view, the ACLI concludes that the single most important step toward maintaining and enhancing a healthy competitive environment in farm mortgages is the establishment of a secondary market for farm mortgage loans. Just as homeowners in communities throughout the Nation have been served by the development of a secondary market for residential mortgages, farmers throughout the country benefit from the development of a secondary market for farm mortgages. The creation of a secondary market for farm mortgages gives farmers access to greater means of lenders and loan terms.

We appreciate the opportunity to discuss the secondary market within the context of your hearing today. As some of you know, we have been active on this issue this past year. We have been meeting with the American Bankers Association, the Independent Bankers Association of America, and with representatives of farm and commodities organizations.

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[1] See p. 522 for the prepared statement of Mr. Ball.

More recently, we, the three commercial lender organizations represented at this hearing, have been meeting with the Farm Credit System to try to structure a secondary market through the System. We are very encouraged by the substances and the cooperative spirit of these meetings. In view of the significant progress and interest to date, we are hopeful that a workable secondary market will be achieved in the near future. Should legislation prove to be necessary to accomplish this, we would welcome the opportunity to work with you.

Current discussions envision the creation of a secondary market for mortgages through the Farm Credit System. The essential elements of a secondary market includes the pooling and securitization of loans, an adequate coinsurance requirement standard, proper loan underwriting standards and appropriate input from users.

Let me illustrate to you briefly why a secondary market is vital to continuing participation by commercial lenders in farm and ranch loans, and why without it we may well see a shrinkage of our role to the point where it is no longer viable—a situation that would certainly be unfortunate for us and for agriculture as well.

In 1968, insurance companies held about $5.5 billion in farm real estate debt, or about 22 percent of the total. At the same time, Federal land banks held about $5.6 billion, also 22 percent. Since that time, although our loaned amount has doubled to $11 billion, our share of the total has dropped to 15 percent in 1968—two-thirds of the earlier level. Meanwhile, the Federal land bank lending grew nearly nine times, to 53 percent of the total market, down from a peak of 61 percent in 1982.

Two key conditions contribute to this change in market share:

First, insurance company funds available for agricultural lending are limited by the company's total asset size, and the proportion of those assets that can be allocated to any particular investment. Farm mortgages are illiquid. Prudent management dictates that only so much of a company's assets can be placed in illiquid investments, particularly in a single industry.

Two, partly in response to agricultural expansion during the 1970's, Federal land banks increased their lending rapidly. Their loan volume growth was made possible by their ability to obtain funds from the Nation's capital markets. Federal agency status made these funds available at advantageous rates.

In short, insurance companies had capital constraints partly due to investment illiquidity. Land banks had unlimited access to funds and lower rates. The shift of market share ensued. I cite these conditions to underline the necessity of liquidity and capital market access if a lender is to compete effectively in today's fast-paced and fluid financial markets.

To assess the merits of the secondary market concept for farm mortgages, the ACLI commissioned economists Stephen Gabriel and Paul Prentice of Farm Sector Economics Associates, a Bethesda, Maryland, consulting firm specializing in agricultural finance, to study the economic implications of creating a secondary market for farm mortgages.

As their study concludes, "creation of a secondary market for agricultural mortgages will give lenders needed liquidity to continue to provide long-term agricultural credit at competitive rates to qualified borrowers. To date, farm mortgages have not been pooled and packaged into securities to any substantial degree and, as a result, no major secondary market has developed for buying and selling farm mortgages."

A secondary market offers advantages to all participants, from the farmer-borrower to the lender to the investor. Although everyone will benefit, the study found that the greatest advantages will flow to the farmers. From the farmers' perspective, secondary market advantages include increased availability of long-term, fixed-rate mortgages, lower interest rates—greater fund availability automatically means borrowers pay lower interest rates than otherwise. Also, at least part of the greater efficiencies experienced by lenders will also be passed along to borrowers in the form of lower rates.

Better service—with more competition from increased funds and lower rates, lenders' services will also have to be more competitive. In general, this will result in more favorable mortgage terms, faster service, and greater choice of mortgage terms and plans.

From the lenders' perspective, a secondary market will produce the following benefits:

Higher yields—total yields to lenders are increased when they can turn over their portfolios rapidly.

Increased origination—lenders may recapture up to 100 percent of their funds for reinvestment in new mortgages. This will provide lenders with liquidity, thus enabling them to originate more loans than otherwise possible.

Increased profits—with increased originations due to a secondary market, lenders increase their income from origination fees. The lender can also earn fee income from servicing those loans. Efficiencies—with larger loan portfolios from increased originations, the lender's average cost of servicing each additional loan is reduced. Diversified risk—for a secondary market for pooled farm mortgages, lenders may choose to diversity by geographic location as well as by commodity type. This will reduce overall risk and therefore lead to lower interest rates.

In summary, key findings of the Farm Sector Economics Associates study are that creation of a secondary market for farm mortgages will preserve the value of farm assets, particularly farm land, possibly shoring up the value by $27.5 billion; make available long-term, fixed-rate loans to farmers; reduce interest rates by 50 to 100 basis points on farm mortgages which meet requirements for securitization; have little or no impact on the Federal budget outlays; improve farmers' borrowing power without increasing production volume; enhance competition among providers of agricultural credit by allowing commercial banks and life insurance companies to continue their role in providing diversity to the farm mortgage market; modernize agricultural lending by accessing national and international investment markets to attract a wide range of investors; and restore balance between Federal land banks and commercial lenders yet provide the Federal land banks with some additional benefits—a new revenue source from fee income, strengthened loan quality in their existing mortgage portfolios due to a stronger land market, and flexibility in matching assets with loan obligations.

The study concludes that Federal support, through an explicit or implicit guarantee, is required to enhance acceptance of these securities by investors.

In the long run, American agriculture should be a full participant in all American capital markets. We believe the creation of a secondary market for farm mortgages is clearly in the best interests of American agriculture. It is essential to reverse the clear and present danger that American agriculture will become increasingly dependent on a single source of long-term credit.

This concludes my statement. Thank you.

Senator BOREN. Thank you very much. I appreciate the statements that have been made by all of you. Let me just address some questions to you, and any of you feel free to jump in and answer them.

What percentage of agricultural loans do you believe that the small rural bank can actually run through a secondary market? Could the small rural banks really run a significant number of their loans through the secondary market?

Mr. DEAN. It wouldn't be an astronomical amount, but we would have—I could think of four or five guys right now that would buy some land if I could get them a good secondary loan.

Another advantage that I did not make in my talk is that the 10 percent, you know, we talk about the stock, everybody has that stock in the Farm Credit System to sort of protect the loans until it comes time to use it.

Senator BOREN. Yes.

Mr. DEAN. Now, this 10 percent would be there upfront all the time, but I think a small country bank, I think we would get half a dozen a year. That is not a lot, but it is doggone important to that guy.

Senator BOREN. Would that help provide some stability to agricultural banks that are currently under so much stress, do you think in the long run?

Mr. DEAN. I do not think it will be in earnings. I think it will give some stability to the farm sector, and anything that is good for the farm sector is going to be good for the agricultural bank.

Senator BOREN. Any other comments?

Mr. LINDHOLM. I have been a participant in this market. I originally was doing more or less arranging for the life insurance companies until about 1979 and then the Federal land bank pricing on the average cost system just kind of took over the whole industry. Now I am finding that the farmers are out there and they are coming to me and I am loading up with farm real estate loans. I thought, you know, I would never get more than I wanted, but now the demand is so great that I am surely looking for a secondary market.

Senator BOREN. How do all of you feel about the concept of having the Farm Credit System administer the secondary market?

Mr. LINDHOLM. Well, this is being explored to a certain extent, but it has to be a joint participation and it has to have more players in this arrangement.

Mr. **Dean**. It seems like the logical way to do it, there was a bill introduced last year, the Cooper-Evans bill, that called for the Secretary of Agriculture to do this. The Farm Credit System, they have got more or less of a setup to get in on that type of thing, they need the earnings, they could be a player in this, too, they could be a pooler and they could be an originator.

There are several ways it could be done and I do not think that we are married to any particular way, but this just seems like the logical way that everybody could agree and make it go at this time.

Senator **Boren**. Thank you.

Mr. **Ranger**. Mr. Chairman, I think that I should reiterate the point that Mr. Lindholm had made, that to have a viable secondary market the management should be and the control should be by the users and we would certainly try to pursue that as much as we could, rather than to have any one particular organization have full control over it.

Mr. **Dean**. I might comment one more, if I may, Senator. The thing is we need that out there now and I would like to be able to start making loans the Fourth of July.

Senator **Boren**. Right.

Mr. **Dean**. We can talk the thing to death and cook up different ideas, but sometime we have got to decide on something that we think will work and get it out there.

Mr. **Ball**. The insurance industry is supportive of working with the Farm Credit System. I think the concerns that we all have is we want to make sure that we all have equal representation in the secondary mortgage market, however it is designed.

Senator **Boren**. How quickly do you believe we could get an agreement of all parties on some specific legislative language establishing a secondary market? Are we pretty close to being able to get that done, do you think, in pretty rapid order with those that are affected?

Mr. **Dean**. We are ready to agree, unless there is some——

Mr. **Lindholm**. I think we are talking about several weeks or a month, or in that area, as you know we have worked quite intensely.

Senator **Boren**. As you know, we are targeting trying to get started on a markup in here and, of course, we would try to work on that along with it. The Easter recess ends the 20th of April and then we will be starting back in earnest after that on legislation.

Mr. **Dean**. Senator, if it is a matter of meetings, you can have one meeting a day or you can have one meeting a week or you can have one meeting a month, let us take whatever it takes to get it out.

Senator **Boren**. We will be back in touch with the various groups trying to get it pulled together so we can get one common proposal. You may all not want to comment on this, but what about the question of allowing unlike associations of the Farm Credit System to merge, how do you feel about that? Or do you want to comment on that?

Mr. **Ranger**. I guess I would have to ask a little more about your definition of unlike——

Senator **Boren**. PCA's, land banks——

Mr. **Ranger**. And land banks.

Senator **Boren**. Yes.

Mr. **Ranger**. Maybe I could comment on that. I am from upstate New York and, as you know, the Springfield district has had that combination for many, many years. As we have competed with the Farm Credit System, we have competed for both the short-term and the long-term portion of the farmers' credit needs. Unlike many other parts of the country and the area that these fellows are from in the Midwest, there has been a very close association between the small commercial bank and the Federal land bank and there is some concern on the part of the bankers that merging the associations, they would lose the short-term or the intermediate-term credit——

Senator **Boren**. To the operational——

Mr. **Ranger** [continuing]. To the PCA's, but they may want to comment more specifically.

Mr. **Lindholm**. I would like to comment. Again, the farmers, the local, we need decentralization here, I believe, rather than a complete centralization. I think part of our problem today came down from above rather than came from below and went on it, and we should learn a lesson from that.

Senator **Boren**. Let me ask Mr. Ball specifically. If we do establish a secondary market for agricultural loans, do you think the volume of loans that insurance companies would be making once this secondary market is fully operational would increase rather significantly?

Mr. **Ball**. I hope you would see a significant increase. I think one of the opportunities it would, it would preserve life insurance companies staying in the long-term agricultural lending business. We have the uniqueness of being able to participate in secondary mortgages at all levels. I think that is one of the—we feel it is an opportunity, if we can create a secondary mortgage market.

Senator **Boren**. Thank you all very much. I appreciate the testimony. We appreciate being able to rely upon your expertise and the viewpoints of the organizations to begin to work on this bill, because we are going to proceed ahead and not let this stay in limbo as it has been for far too long.

Mr. **Dean**. Thank you, Senator.

Senator **Boren**. Thank you very much.

We are going to turn quickly now. The bankers were just here, and they will understand that there is some important banking legislation on the floor right now that particularly impacts the financial systems in highly distressed States, and so I am going to have to go to the floor rather quickly, but I do not want to short-circuit the hearing. We have two farmers that are here to testify today and I want to ask Donald Cundall, from Guernsey, Wyoming, to come forward and also my friend, Don Schieber, from Kildare, Oklahoma, to come forward.

We are very happy to have you here and we are very pleased to have the opportunity to hear your testimony. I guess, while I will not be accused of bias, I guess we will let Wyoming go before Oklahoma. Senator Wallop came out and was pinch-hitting for me while I was going to go over to the Senate steps earlier in our break period to greet a group of Oklahoma students, and when I got there

Senator Wallop was pinch-hitting for me today, so we appreciate Wyoming's assistance.

STATEMENT OF DONALD R. CUNDALL, FARMER, GUERNSEY, WY

Mr. **Cundall**. Thank you, Mr. Chairman.

Senator **Boren**. You are a member of the State Senate, I believe, also?

Mr. **Cundall**. Yes, sir.

Senator **Boren**. We appreciate having you here with us.

Mr. **Cundall**. I have a short presentation, Mr. Chairman, and I might elaborate a little bit as I go along.

My name is Don Cundall and my address is Wendover Route, Guernsey, Wyoming. Together with my four sons, I am in the livestock business in southeastern Wyoming. We operate as a limited partnership. That might give you a clue to our problem right there, that I have four sons who wish to stay in the business.

As was the case with many people, things began to go bad approximately in 1980. In 1984, we hired a nationally known financial consultant from Tulsa, Oklahoma, to help us put together a plan that would improve cash flow.

We submitted this plan, which consisted of deeding back about 75 percent of the land we owned, then leasing it back from the Farm Credit System. This seemed to be acceptable at the local level and was sent then to Omaha for final okay. After some months, our plan was rejected by the System, but they would not say why and refused to let us sit down and talk with the people who made the final decision.

It is interesting for me to note here today, Mr. Chairman, that they are leaning toward that sort of a solution now.

In January 1985, we filed chapter 11 under the U.S. Bankruptcy Code, and since that time I have learned more than I care to know about the process.

I also serve as a State senator, representing Platte County, so when I filed a chapter 11, it gave me rather high profile.

Senator **Boren**. I understand.

Mr. **Cundall**. I began to get calls from people around the State who had financial problems and, of course, I did not have the answers as they hoped I might. The fact that so many people were grappling with all the complicated and stressful problems caused by the financial crunch prompted me to put together some seminars on financial planning, accounting and chapters 11 and 12 of the Bankruptcy Code. Many of these businesses that contacted me have survived for four or five generations, which indicates to me that most of this financial debacle is caused by factors other than what the operators had control of.

As of this date, we have held two of these seminars with an attendance of about 90 people each. We plan to hold at least three more. The Wyoming Rural Support Network has helped me to organize these seminars. They are a group which was originally set up when farmers and ranchers began taking their own lives as a solution to their financial problems. We thought maybe there was a better way.

Participants in the last seminar consisted of Bud Murphy, of Murphy Management Associates, of St. Cloud, Minnesota; Jerry Hirschfield, of Kern, Poganski & Hirschfield accounting firm, also from St. Cloud; Melanie Rovner Cohen and James A. Chatz, of Antanow and Fink, attorneys-at-law, Chicago, Illinois; Robert Stanton, U.S. Justice Department; and the Honorable Keith Lundin, U.S. Bankruptcy Judge, of Nashville, Tennessee.

As I talked with people who attend these seminars and also people who call me, I find that there is certain consistency at least as far as the Farm Credit System is concerned:

Number one, loans do not get processed timely. For instance, a loan that is appiied for in March might not be granted, if granted, until midsummer. Money that was for purchase of cattle is of little value if the opportunity to make a profit has already gone by.

Second, they asked for additional security, then when it is granted, they do not fully fund the operation. Undercapitalization is almost certain failure.

Third, the State of Wyoming has a very good long-term loan program for loans up to $400,000. In several cases, Production Credit has encouraged borrowers to apply for a State loan to cut down short-term debt. After they get the loan, Production Credit has taken the money and run, cutting off the producer's short-term money and leaving him dead in the water.

Fourth, the System seems determined to sell out the present operators, even though they could survive if given the same break as new owners. I have not seen any ads about "Buy Wyoming," but the Minneapolis Star-Tribune ran an ad on Sunday, February 1, 1987, saying "Buy Minnesota—4.9 Percent." I suspect you might have seen this ad.

Senator BOREN. Yes.

Mr. CUNDALL. "Buy Wisconsin," came out on January 11. I am sure that this concerns every operator.

Those of us who have been through this process, think we have been punished sufficiently.

Some way, the System needs to be restructured so that the borrower has access to the loan officer or board who makes the final decision. It seems to me there is no way to properly evaluate a loan.

The System needs to accept realistically that the loss is there. The Farm Credit System can come out of this with the reputation of putting people back on their feet again if they assume the right attitude. That was the reason they were formed in the 1930's, and with a complete restructuring they could and should do it again.

Even though you might have equity, the Farm Credit System will approach you to sign over all of your assets. They just hope that you will become discouraged and walk away.

Producers have had almost blind faith in the Farm Credit System. We are the only segment of the economy who completely trust the banker to treat us right. We might borrow from $800,000 to $1,000,000 a year at whatever interest rate the banker has in mind that day—and, of course, in that area I refer to some cases, of course, where the System, the land bank system has broken their debts down into different categories and charge a different rate to each one.

If anyone else were to approach the bank, any other business, they would have taken financial advisors and a lawyer perhaps and negotiate the best deal in town. I am also amiss again today, Mr. Chairman, that I do not have my lawyer with me. [Laughter.]

I do not come before you today to say producers have not made some mistakes. I have seen abuses on both sides. But in Wyoming we have a vast majority of hard-working young men and women who ask nothing more than to survive. They are proud of their occupation and proud of their honesty and integrity, as well they should be. Nothing would please them more than to repay every dollar they owe, with interest.

Congress did, I am sure, try to address the family farm in chapter 12, but in Wyoming it seems to have missed the mark.

A great many of our ranches are a family corporation or partnership. These were formed as a vehicle to move real estate from one generation to the next. What they really are is a group of family ranches. If there are three or four or five families, then their debt usually exceed the $1.5 million limitation. I cannot feel that it was the congressional intent to treat some different than others. Perhaps this is in hindsight.

I appreciate the opportunity to appear before you here today. I can quote many personal incidents that have occurred in the State due to my contact with these people through the seminars and some of them are really disheartening because they are old family, good operating units that are losing the ball.

Restructuring seems to me is the only way that these people are going to survive. I have been very encouraged by the testimony here today and the suggestions that have been made, but it seems to me that it would make a great deal more sense to exercise some forbearance at this point and try to keep the people there that are on these places. They have a love for the land and they have a great deal of their liveswork in that particular piece of land and would much rather stay there than move on. I think if you actually put the pencil to it and compared it with what they would get by foreclosure and sale to another owner, many people could stay on under those terms.

I think it would be very important to the economy in my State and to the Nation as far as that is concerned to do this.

Thank you.

Senator Boren. Thank you, Senator Cundall. I certainly agree with you. I think that they are—and even beyond putting the pencil to it, you know, there is just value in terms of the fabric of our society in trying to cause that to happen. I have been in many of those situations that you have been in and there are heartbreaking situations to see people of third and fourth generations and grandparents and even sometimes further back than that that have had that land and the attachment to it—there are a lot of people now that have been good stewards and are just simply caught up in economic forces beyond their control. I think they are pretty well washed out long before this, those that were not good managers. We are cutting into the bone now, we really are and it is really a difficult situation.

You mentioned the idea of deeding 75 percent back and the lease-back arrangement, a purchase-back arrangement. I guess this is somewhat similar to Governor Bellmon's proposal. I do not know if you were here this morning when the statement was read from Governor Bellmon.

Mr. **CUNDALL**. Yes, I was.

Senator **BOREN**. Governor Bellmon's proposal was similar thinking. Would it always be 75 percent or were you using that as an example? In other words, could it be flexible? If you did not need to use as much as 75 percent, could it be a range?

Mr. **CUNDALL**. I do not think there is anything sacred about the 75 percent. That just happened to be the plan that we submitted at that time.

Senator **BOREN**. If you could adopt a mechanism, in some cases it might only be 50 percent or whatever, it might need to be 80 percent.

Mr. **CUNDALL**. More or less, any figure that was acceptable.

Senator **BOREN**. Right. And would you provide for repurchase then in the future?

Mr. **CUNDALL**. Well, I think this would be a good thing if you could buy the land back. Again, I think those people would give more for that land than anyone else, because they have a particular love for it.

Senator **BOREN**. Sure.

Mr. **CUNDALL**. I am sure that most of us get too attached to a particular spot, but it is true and most farmers and ranchers would like to stay on the particular area at least.

Senator **BOREN**. Well, I appreciate your comments very much. You have a good suggestion and if there is any way when we work on this that we can figure out a way to put preference on keeping those people on the land that are there, I think we would be doing something very, very important. It is not only economically the right decision, but in the long run I think it is right from every other point of view. If there is a strong stabilizing force on the part of the whole country, it is to try to keep that.

Mr. **CUNDALL**. I certainly appreciate the work that you have done on this, Senator, in the hearings that you have had.

Senator **BOREN**. I feel like we have had a very constructive hearing today. I think we have had more good thoughts. There are hearings in which everybody kind of comes and uses a lot of rhetoric about the problem but no one comes up with any specifics. Today, I think we have really had some excellent suggestions, very constructive suggestions that have come forward and I am starting to grapple with this and it is long overdue.

Don, we want to save some Oklahoma wisdom on which to close here. We are very happy to have you with us and we will be glad to hear from you.

STATEMENT OF DON SCHIEBER, FARMER, PONCA CITY, OK

Mr. **SCHIEBER**. Thank you, Senator.

As you know, our farm credit problems in Oklahoma have been compounded by the 500-year frequency flood that we endured last October—September and October.

Senator **BOREN**. We have been making history in areas that we did not want to make it.

Mr. **Schieber**. It seems that every time the sidewalk dries off it rains. We have been averaging about 4 inches a week now for quite some time.

I come today fearful that my loan might be targeted and I am a borrower in the Wichita ninth district. Even though I am current on my loan, I have that fear. Many borrowers will not speak out because of that fear. If I could find the ticket, I would take the first plane out of the System. The last plane just left and I am kind of stuck, so I am going to do what I can to help turn things around.

Many borrowers use deficiency payments to make their Federal land bank loan payments. In the last 2 years, deficiency payments have not been made when they were supposed to be, so that has put many farmers delinquent on their loans over a period of time.

Well, as a result of that, farmers' interest rates have gone up, they are not eligible for reductions for at least 5 years if they can continue to make their payments on time to those 5 years. That is a big problem that we have.

I feel that legislation must be aimed at borrowers. I do not feel that we should help the System without helping the borrowers. If there is any infusion of funds, they must include a mandate to lower the interest rate and if there is an infusion of funds into the System they should not come out of CCC or any other USDA program.

Senator **Boren**. Absolutely.

Mr. **Schieber**. Legislation must also protect the investors, even though we do not know who those investors are. I have been told that Lloyds of London is one of the large investors in the System, which is foreign investment.

If the System goes down as I see it, we will have automatic nonagricultural investors, including foreign entities, owning land, similar to what has occurred in other industries.

Now for my specific proposal, in the essence of time I ask that my proposal in its entirety be entered in the record.[1]

Senator **Boren**. We will. Your full statement will be placed in the record.

Mr. **Schieber**. This is a proposal to allow earlier repayment of long-term land ownership loans similar to Federal land bank and FmHA loans. Earlier loan repayment is accomplished by allowing the borrower to split his loan payment into two equal sums. One sum is applied to the principal, the other sum is applied to the interest. Under the normal 30-year amortization schedule, for about the first 25 years you are paying more interest than you are principal in your payment. When you split your principal and interest into two equal sums, this will leave a short-fall in the total amount of interest due annually.

In the proposed plan, interest and principal are equal until the eighth year, when the interest is less than one half of the annual payment. The only way this can be accomplished is with the help of a subsidy or partial debt set-aside for a short period. The subsidy or the set-aside amount will be repaid in this plan when a zero principal amount is reached at year 14, so in essence we will be paying off a 30-year loan in 14 years under this proposal.

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[1] See p. 539 for the prepared statement and proposal submitted by Mr. Schieber.

One requirement of the plan is that the borrower must still make the same annual installment. The amount required for subsidy will vary for each loan, depending on which payment is currently due, whether it is payment five, six, or seven, wherever he is in his repayment schedule.

The farther into the repayment schedule, the less is required for subsidy. This is a great deviation from the standard 30-year plan, for each year more of the annual payment is applied to the interest than principal. The following narrative and charts and graphs explain the 30-year plan and the proposed plan. Both plans are discussed and focused on a $100,000 loan, at 12.5 percent interest rate, 30 years. This is done only for illustration and comparison purposes.

I also included graphs and charts of schedules of amounts of each payment for each year and I included the breakdown of how the proposed plan would operate for 12.5 percent loan, 9 percent loan, or 9.5 percent loan and 7 percent loan. Also included are amortization schedules for $100,000 loans at 7 percent through 13 percent at half-point intervals, and I would be happy to explain this in detail at your pleasure.

Thank you.

Senator **Boren**. Thank you very much.

I will just ask a couple of brief questions, because I am unfortunately going to have to go. It is a crazy world around here, everything always pops up at the same time, and when you set hearings ahead you do not know when these other matters are going to arise.

Let me ask, would you extend the eligibility for this program to all borrowers, regardless of their institution or just for farm credit or would you also extend this kind of a program for other borrowers?

Mr. **Schieber**. Well, if they have a 30-year loan, where this type of amortization would apply, I think they should be eligible for it. I mainly aimed this at the Farm Credit System. If we extend it to all the borrowers in the System, then it would help keep the people that are leaving the System in the System, as well as the ones that are marginal. But we are also looking at what your financial statement would look like each year, because you are increasing your equity.

Senator **Boren**. Part of how much the subsidy you would get would depend upon really where you are in your loan, would it not? I mean some would be getting more subsidy, really——

Mr. **Shieber**. Right.

Senator **Boren** [continuing]. Depending on how far into their period of repayment?

Mr. **Shieber**. That is just the luck that they draw.

Senator **Boren**. Just the luck that they draw.

Mr. **Shieber**. I think most people are probably in year five, six, seven or eight, somewhere in that range, and you could probably take the last two subsidy payments and drop those because they are relatively small.

Senator BOREN. Well, I appreciate your idea. We discussed this a little bit before and it will be very useful to us, especially to have your full detail of it in the record as we go into this.

Mr. SHIEBER. Anything I can do to help, please call me.

Senator BOREN. I appreciate it very much. You know, it is a sad commentary I think when you made the statement that if there was any way to get out of this System now you would do so. And hearing what Senator Cundall said earlier, you know, we have had such dependence on this System for such a long time, and there has been such a feeling over the years. I remember some of my earliest memories as a boy was being taken by my dad to PCA meetings and sitting in, and there was a real feeling of association, the System belonged to the farmers and the ranchers, there was a real participation in it and I think a real trust in it and a real functioning in terms of people who knew who the good operators were, they knew how to make those loan decisions.

I was talking with somebody the other day whom I had known, who was an orphan, as a matter of fact, and he had done extremely well. He was in the oil business and was in the farming business, but he started out with nothing. He started out working for a man driving a truck and then he finally went down to the local bank, he was such a hard worker, and the banker knew him and he said would you loan me the money to buy my own truck. He did and he did well with that and he worked hard. He was known in the community and pretty soon they loaned him the money to buy a second truck and before you knew it, over a period of time, he had quite a large operation on-going, starting with nothing really but his reputation, the reputation he established for being a hard-worker and a good manager, and that is so much a part of what our economic system is all about.

When I think about free enterprise and our economic system, that is what it is all about. It has to be open to the opportunity for people that want to work hard that might not have very much to start with. You know, the System over a period of time has been policing it and these are the kinds of people you want in the community. You knew the farmers who were good operators, you knew the ones that did not overspend and buy the new pickup every year whether they could afford it or not, and you knew the kind of people that were playing a role in the community and you could stay with them, and that is so important.

And to move from that point to the point where we have had tactics by people threatening free speech of members who were bulwarks and officers of local associations and people who are barred from the System. From that to the kind of control from above in a self-serving way with a bureaucracy that seems to be more interested in sustaining itself and its own benefits than in the health of the System. You know, that is a tragic transformation of what has been a very, very valuable part of the whole agricultural community, and to see this thing in more of a shambles than it was even at the heart of the Great Depression is just a tragedy indeed.

So I hope we can find a way. I do not mean to pretend that I have all the answers, but we do intend to make a good, honest effort to try to get the thing back the way it should be.

Mr. SCHIEBER. I might make another comment. Even though a lot of us farmers are in trouble, some of the decisions that we made in the last 5 or 6 years now seem to be bad decisions, but at the time those decisions were made in most cases it was the right thing to do at that time.

Senator BOREN. Absolutely.

Mr. SCHIEBER. Now we would not be in trouble if our commodity prices were where they belonged.

Senator BOREN. Yes. That is right.

Mr. CUNDALL. Mr. Chairman, you know I might as well tell the rest of the story. I had an opportunity to either take an insurance company loan or a land bank loan on the last piece of land that we bought and I pursued the insurance company loan and put up some $8,000. At that point I was loyal enough to the Farm Credit System that I had thought if things turn bad, they will stay with us and I backed away from that insurance company which would have been a 10 percent loan at a fixed rate, and went with the System and, of course, it has proved now to be a very terrible mistake.

So when people talk today about making other areas available and competition within the market, I can sure hear them loud and clear.

Senator BOREN. I understand what you are saying. But it is a sad turn of events and one that we hope we can have some impact on.

Thank you all. Thank you for your constructive suggestions. As I say, we are going to make a monumental effort here. You never know when you start making an effort how successful you will be in all areas, but we are going to make a monumental effort to come up with a constructive solution and one that will get this System back into stability again.

Thank you very much. The hearing is adjourned.

[Whereupon, at 4:24 p.m., the subcommittee adjourned, subject to call of the Chair.]

APPENDIX

FEBRUARY 26, 1987 HEARING

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

Mr. Chairman, I am happy to be here today to participate in these important hearings. I would like to commend you for bringing together this broad range of witnesses for our opening hearing on one of the most important problems facing American Agriculture.

These are important hearings. Farmers are being forced off their farms in increasing numbers as the financial crisis of agriculture worsens. At the same time, the Farm Credit System is fighting for its survival. Should it fail, the implications for farmers with mortgages held by the System would be staggering.

Last week's release of the 1986 results for the Farm Credit System only served to emphasize the continued hemorraghing of the System. Losses in the past 2 years alone have totaled over $4.6 billion. It is becoming increasingly clear that direct Federal assistance may indeed be necessary if the American Agricultural situation doesn't improve dramatically.

However, simply throwing money at the System is not the solution. Any Federal assistance must be coupled with a restructuring of the System to assure that the Farm Credit System will remain a long-term source of reasonably priced credit for agriculture.

Congress, in providing any aid to the System, must also be fair. The equitable treatment of System, its various associations, and the thousands of farmer-borrowers is central to the debate on the future of the Farm Credit System.

Recent events have shown that the current regulatory procedures for pooling resources among the various parts of the System are not workable. The essence of any cooperative enterprise is a sharing of benefits and liabilities. Nevertheless, sacrificing healthy farm credit districts, when their resources are clearly inadequate to deal with the magnitude of the total problem, is not the answer.

I believe that we must look for means for assisting the Farm Credit System which preserve the viability of districts which have managed to avoid the worst of the recent financial crisis. If we weaken the healthy districts to the point that they become an additional drain on the System—and the taxpayers, as well—we are merely compounding the problem and not resolving it.

For those district banks and associations in severe trouble, assistance that preserves the cooperative nature of the System and ensures adequate capital for the farming sector is vital. We have heard several witnesses indicate that the problems of farmers and the problems of the System are the two sides of a coin and that restoring one to health will require the restoration of the other. Hearing such as these will provide invaluable assistance in helping us determine how we go about doing this.

Again I would like to commend Senator Boren for these hearings as a forum for discussing this important topic. The information from these hearings will be extremely valuable in moving the committee forward on this issue.

STATEMENT OF HON. EDWARD ZORINSKY, A U.S. SENATOR FROM NEBRASKA

Mr. Chairman, I commend you for having this hearing on the structure of the Farm Credit System. Today's hearing will help guide the Committee in its consideration of the present condition and future viability of the System in fulfilling the credit needs of our nation's farmers.

The recent field hearing on farm credit in my home town of Omaha, Nebraska signaled only the beginning of this year's deliberations on the critical credit issues. In Omaha, we learned that legislative action in the 99th Congress has not solved the acute credit problems.

Farm Credit Services of Omaha continued to lose money, reporting combined net losses of $82.6 million in 1986. The condition of the System, of course, is a reflection of the poor farm economy. Between June 1985 and June 1986, we lost approximately 2,000 more farmers in Nebraska. Although land values are stabilizing, they have yet to hit bottom.

Farm Credit System institutions continue to charge interest in excess of commercial rates. The loan volume for all three banks in the Omaha district fell from $6.3 billion in 1985 to $4.7 billion in 1986. Clearly, the best borrowers, those that are financially able, are leaving the System.

We obviously need to take a step back and review the delivery and servicing of credit not only through the Farm Credit System, but through commercial lenders and the Farmers Home Administration. In light of the significant Farm Credit System losses again in 1986, however, it is appropriate that we focus our immediate attention on the System.

Unfortunately, this is not the first time we have needed to assess the difficulties facing the System. In fact, the System has been a source of concern for the last few years.

On September 17, 1986, the full Senate Agriculture Committee held a hearing on the financial condition of the Farm Credit System. In that hearing, I was interested in the witnesses' views as to whether they believed the financial health of the System institutions would improve and what legislative action—if any—would be helpful in hastening that recovery. Although we subsequently passed the Farm Credit Amendments Act of 1986, which allowed for the changes in the System's accounting rules, the issue remains—what legislative action will be necessary to restore the financial vitality of the System?

Today's witnesses should provide timely testimony about the problems of the Farm Credit System, and how those difficulties are affecting farmer-borrowers. The witnesses will be most helpful if they can identify legislative mechanisms that can be used to assure that farmers will be able to obtain credit at reasonable rates of interest.

Mr. Chairman, I look forward to hearing the testimony of the witnesses.

STATEMENT OF HON. MITCH McCONNELL, A U.S. SENATOR FROM KENTUCKY

Mr. Chairman, pardon me if I sound a little cynical, but I am beginning to wonder how much longer the Farm Credit System can continue to operate under the siege metality that is permeating the System. This hearing marks the third time in 15 months that this Committee has been asked to take a look at the health of the System and consider legislative alternatives to improve its viability.

It seems to me while we're doing all of this reviewing, the entire System is crumbling.

The Farm Credit System is in trouble—there's no one who'll argue that point. How it got into trouble is really of little consequence in the context of today's hearing. I thought it was fairly clear last fall that the System did not have the financial resources to maintain its economic viability with the enormous losses that were, and still are, being incurred. I discussed this notion with my colleague on this Committee, Senator Cochran, when he introduced the farm credit legislation which was enacted in 1986 as a part of the Budget Reconciliation Bill.

Senator Cochran advised me that his discussions with FCS officials, and others who have an abiding interest in the health of the Farm Credit System, led him to believe that the revised accounting procedures and the interest rate setting mechanisms which were included in his legislation would give the System the breathing room it needed to get back on its feet. I believed the Senator's legislation would help, but I contended that it didn't go far enough. I think time has proven me correct.

The Farm Credit System is in serious financial trouble. It has lost billions of dollars in the last 2 years. A federal judge has already determined that the sharing arrangement which was the backbone of the 1985 Farm Credit legislation is not legal as it is now being administered. Despite their best efforts, the System has not stemmed the tide of lost borrowers even with more competitive interest rates.

This situation is kind of like being a little pregnant—you either are or you aren't. Mr. Chairman, either the Farm Credit System needs money or it doesn't. I want to hear it from them. I say to the witnesses who are assembled here today to tell us you need help. Don't beat around the bush. We know the causes. We know about lost borrower confidence. We know about improving administrative management within the System. What we don't know is what you would like the Members of this Committee to do to help the System and the borrowers it serves.

Mr. Chairman, the Farm Credit System has its most sympathetic audience in the Congress right in this room. But speaking as one Senator, I'm becoming a little impatient for things to improve as we've been promised for these last 15 months. The farmer-borrowers in Kentucky don't need another short term band-aid fix. If the Farm Credit System is worth saving, and I believe it is, then I submit Mr. Chairman that it's time for this Committee to take the kind of substantive action needed to effect some meaningful results.

"If it ain't broke don't fix it". We've all heard that abouit hundreds of things. Well Mr. Chairman, this "it" is the Farm Credit System and it is broke. Let's do something once and for all to fix it.

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Mr. Chairman, I want to thank you for the opportunity to testify before your subcommittee today. This hearing serves a very important role as we approach the time the Farm Credit System will need assistance from Congress. I am particularly pleased that this hearing will focus on the historical value and purpose of the system. Over the past few years I have held several hearings in regard to the Farm Credit System and strongly believe that the system has drifted too far away from its mission to serve the family farmer.

During your hearing today you will hear much discussion about the financial condition of the System and the Farm Credit Administration's regulatory role in overseeing System activities. I don't think it is necessary for me to reiterate all that will be said and has been said except to say that I believe it is quite obvious the System will come for help in the near future. Whether that help comes through the Appropriations Committee or the Agriculture Committee as the authorizing committee is really not the point. The point is that we need to make sure that the farmers are not forgotten this time around. Too often in the past couple of years in the rush to do something to shore up the deteriorating financial condition of the System we have ignored stockholders rights, local control, and borrowers rights (i.e. forbearance, restructuring, etc.). I stand ready to work with the chairman, because I know he feels the same way I do about this, as a member of the Agricultural Subcommittee on Appropriations and to ensure these important issues are addressed no matter what route through Congress this assistance takes.

The system was founded by Congress to serve farmers and ranchers, and to be owned and operated by farmers and ranchers. Unfortunately, in reality, the System has drifted away from that. Almost every time I talk to a local board member or stockholder a statement comes out to the effect "We don't control the System anymore" or "I don't know how that decision was made they just told us that is the way it is going to be". I not only find that sad but I find it irritating. It is time for us to remind the employees of the System just who their bosses are. Whatever we do in any assistance package lets not make the mistake of thinking that the System's problems are the result of too much local control. I believe quite the opposite is true. I believe that many of the System's problems are the result of too many very big decisions being made by too few of people and then those decisions having a very broad negative financial and economic impact.

In addition to local control we need to also concentrate on stockholders rights. In many ways these two are the same thing. For example, I often hear from farmers who simply want to communicate with their fellow stockholders about the direction their bank or association is taking but they don't know who their fellow members are. When they go to their bank or association's office and ask for a list of their fellow members they are told they don't have a right to that list. I not only think that is wrong but I think it is denying a right to the owners of the System to communicate with each other. In addition, many stockholders run into trouble when they try to find out the bylaws and rules of their institution. I don't think a stockholder should have to be concerned about being mistreated just because he wants to be active in overseeing how the bank or association he owns is run. Maybe even a sadder commentary is that many members have got used to these activities as being "business as usual". I think that all these farmers and ranchers need to be reminded of their rights and guaranteed their rights. They need to be told that they not only have a right to these things but they have a responsibility for making sure their System is being run right.

Also we need to make sure that all these farmers experiencing financial difficulty are given a fair opportunity to succeed. Don't misunderstand me, I'm not saying that every farmer has a right to farm or to a profit. But I do think that they should be treated at least on an equal footing with some outside investor and should be given the first shot at lower interest rates and other "sweetheart deals" that a new person may get. Now, if he can't make it even under the best of terms and conditions it may be necessary to look in other directions. Let's give this family farmer a fair shake.

Finally and in closing, I would just like to say that we should structure any assistance in such a way as to maximize interest rate relief to farmers. Again, lets not get into a situation where we are saving a financial institution and not helping the farmers. I believe that is poor economics and also just plain poor policy. The Systems only value to me is in its mission to serve the family farmer. If it doesn't do that it doesn't serve any purpose in my mind.

Thank you again for this opportunity and I stand ready to work with you in any way I can.

STATEMENT OF WAYNE D. RASMUSSEN, AGRICULTURAL HISTORIAN

Mr. Chairman, Members of the Subcommittee, I am pleased to be here today to discuss the historical background of the Farm Credit Administration and its programs.

Throughout our colonial and national history the frontier farmer found it difficult to secure credit. Money was usually scarce, prices low, and both interests rates and risks high. The situation became acute after the Civil War. The Western farmer was of necessity a commerical farmer, while many Eastern farmers were making the change from subsistence to commerical farming. The establishment of a commercial farm and its continued existence depended in many cases upon the availability of credit. The Southern farmer, too, was in need of money to re-establish or establish himself in the production of cotton.

Farmers' needs were the more acute in that the federal government was aiding financial and business interests by reducing the amount of money per capita in circulation. Many farmers turned to the Greenback movement, the Populist party, or free silver as promising aid, but all failed in their attempts to get more money into circulation. Sensitive to the needs of the business community, the government was indifferent to the farmers' financial problems.

The first governmental recognition of the farmers' credit needs came in 1908 when President Theodore Roosevelt's Country Life Commission called attention in its report to the lack of any adequate system of agricultural credit. The commission commented upon the cooperative phases of mortgage credit and posed the entire problem as one needing solution. The Commission saw a formal rural credit program as promoting rural life and welfare as well as serving to stabilize farm production.

The National Monetary Commission, appointed by President Roosevelt in 1909 to study general banking conditions, presented a detailed account of the German rural credit system. The American Bankers' Association carried on futher studies. In the spring of 1912, the Southern Commerical Congress persuaded David Lubin, founder of the International Institute of Agriculture, to discuss the problem at the annual meeting of the Congress. With Lubin's encouragement, the Congress appointed an unofficial American Commission on Agricultural Credit and Cooperation to visit Europe in 1913 and study different agricultural credit systems.

Meanwhile, early in 1912, President Taft asked American diplomatic representatives abroad to gather material on European systems for a report. This report was sent to the state governors in the fall of 1912. In his transmittal letter, the President outlined the problem and stated that the federal and state governments must assume responsibility for "economically and honestly conducted institutions."

Action seemed assured when, at their 1912 conventions, the Republican, Democratic, and Progressive parties pledged themselves to better credit facilities for the farmer. In the spring of 1913, President Wilson appointed an official United States Commission to cooperate with the American Commission on Agricultural Credit and Cooperation. The commissions issued their report in the winter of 1913–1914, and legislation to effectuate their recommendations was introduced early in 1914.

Action on legislation was delayed by the need to reconcile three opposing views. One plan called for the establishment of privately-owned farm mortgage banks under the supervision of the federal government. Another was for the organization of a system based on cooperative principles, while the third plan was for the federal government to make direct loans to farmers. It was not until July 17, 1916, that the Federal Farm Loan Act was passed and signed by the President. The compromise act permitted the establishment of both privately-owned and cooperative farm mortgage banks.

The agricultural credit system was modeled upon the federal reserve system in its general outline as well as in many details. Corresponding to the Federal Reserve Board at the head of the federal reserve system was the Federal Farm Loan Board. The federal land banks occupied a position analagous to that of the federal reserve banks. The national farm loan associations of the agricultural credit system were to it what the individual member banks are to the federal reserve system. The joint stock land banks presented a structural difference, but otherwise the outlines of the two systems were almost identical, and the joint stock land banks were comparatively short lived. Congress, in passing the original Federal Farm Loan Act in 1916, made it quite clear that it expected the Federal Land Banks and the Federal Land Bank Associations to become a cooperative credit system in which farmers would have the responsibility of organizing and operating their local associations, and in owning and having a voice in running their district Federal Land Banks. That is, a decentralized system that in time could be controlled by the farmers themselves was established.

Congress provided the original capital for the Federal land banks with a provision for farmers to organize local associations. As farmers obtained long-term mortgage loans from the land banks, they were to invest 5 percent of their loans in the capital stock of their local associations. The local associations would in turn invest in the capital of the Federal land banks and gradually replace the Government-owned capital. They were to operate at cost. The joint stock land banks were to be capitalized by private interests, and operate to make a profit for their stockholders. Both the systems were empowered to sell bonds to the investing public to raise money for making loans to farmers.

The federal land banks, by making available amortized loans for periods as long as 20 to 40 years throughout the country, brought about fundamental changes in farm mortgage lending. They eliminated the need for high interest rates and renewal fees every 3 to 5 years. Other lenders gradually began to follow suit in order to compete.

In 1923, Congress authorized the organization of the 12 Federal intermediate credit banks to work alongside the Federal land banks. These banks by discounting farmers' short-term notes were to provide funds for operating purposes. The banks were wholesalers of credit. Congress hoped commerical banks would use their services and that farmers would also organize local associations to serve as retailers of credit. The banks were also authorized to lend to farmers' marketing cooperatives on security of commodities in storage. Federal intermediate credit banks had only limited use up to 1933 because of the lack of retail outlets. Congress had authorized the Secretary of Agriculture to lend farmers the money to organize local agricultural credit corporations to use the facilities of the Federal intermediate credit banks. However, only a few were organized.

Starting as early as 1918, the Secretary of Agriculture had been authorized and funds had been provided, from time to time, to make emergency seed, crop, and feed loans. The authority to make such loans was transferred later to the jursidiction and control of the Farm Credit Administration.

Useful as the land banks and the intermediate banks were to individual farmers, they were unable to stem the ravages of the continuing farm depression of the 1920's. Then when the Great Depression hit the Nation in 1929, farm prices, already down, went down further and faster than anything else. The Federal Land Banks were dependent upon installment payments on their loans to pay interest on their bonds, but many farmers were unable to make payments. The situation made it almost impossible for the banks to sell bonds so loan funds dried up. In 1932, the banks made loans totaling only $28 million to 7,000 farmers in spite of the fact that many more were clamoring for money.

Meanwhile, in 1929, upon the recommendation of President Herbert Hoover, Congress had established the Federal Farm Board with a revolving fund with which to make loans to cooperatives. The cooperatives were to hold and market commodities over the year instead of having farmers selling all at once at low prices at harvest time. Worthy as the goal was, the advent of the Great Depression, brought about at least in part by the continuing farm depression, made it impossible for the Farm Board to stabilize farm markets.

A number of rapid actions were taken by President Franklin Delano Roosevelt and Congress to solve the desperate credit crisis which faced American farmers. By 1933, farmers' income was approaching the vanishing point. Lenders were foreclosing mortgages by the thousands. Hundreds of thousands of other farmers were without credit and threatened with the loss of their farms.

In the Midwest, some farmers joined what they called the Farm Holiday Association and, in addition to trying to stop the movement of products to market, they threatened violence to stop foreclosures. Additional legislation was needed to enable the government to meet the desperate need for emergency credit.

Congress made provision for emergency credit by passing the Emergency Farm Mortgage Act of May 12, 1933. This act provided a $200 million fund to the Land Bank Commissioner to make both first and second mortgage loans to refinance farmers' debts as a supplement to financing by the Federal land banks. These loans were handled through the existing Federal land bank system. The Emergency Farm Mortgage Act also provided for a temporary reduction in interest rates on Federal land bank loans. The land banks were reimbursed from the United States Treasury for the differences between the interest rate the farmers contracted to pay and the emergency rate established by Congress. The legislation provided for extension of time to worthy land bank borrowers who were unable to meet their payments, by authorizing the United States Treasury to subscribe amounts to the paid-in surplus of the banks equal to amounts deferred. The act also provided for the liquidation of the joint stock land banks.

The establishment of the Farm Credit Administration by executive order on May 27, 1933, was followed by the Farm Credit Act of June 16, 1933. The Farm Credit Act provided for the establishment of local production credit associations to bring the services of Federal intermediate credit banks to farmers. It provided the original capital to organize these credit cooperatives, but arranged for farmers to gradually replace the Government-owned capital by investing in stock in proportion to the size of their loans. The Farm Credit Act made funds available to capitalize 12 district banks and 1 central bank for cooperatives.

The Farm Credit Act was followed by the Federal Farm Mortgage Act of January 3, 1934. This act used the Land Bank Commissioner fund to capitalize a Federal Farm Mortgage Corporation to expand the money available for emergency financing.

The additional authority and funds enabled the Federal land banks on their own behalf and for the Federal Farm Mortgage Corporation to stem the tide of foreclosures, save the farms of hundreds of thousands of families, and incidentally help unfreeze the assets of country banks and insurance companies. From May 1933 to the end of 1935, the land bank system on its own behalf and for the Federal Farm Mortgage Corporation made 726,000 loans totaling nearly $2 billion. By the end of 1935, the Federal land bank system, together with the Federal Farm Mortgage Corporation, held 48 percent of the total farm mortgage debt of the country. The refinancing program cut farmers' interest bills by about $38 million a year. In addition, many creditors agreed to scale down farmers' debt to them so farmers might be eligible for mortgage loans and thus enable creditors to get cash. These scale-downs totaled an estimated $200 million.

The Frazier-Lemke Amendment of June 28, 1934 was the most controversial law relating to farm mortgages ever passed by the Congress. This law, to be in effect until 1938, called first for voluntary and then for compulsory negotiations between creditors and debtors. If agreement could not be reached, the debtor could not foreclosure on the property for three years. The law was declared unconstitutional in 1935 and was replaced by a revised Frazier-Lemke Act which gave creditors more protection. This act was renewed until 1949, when it expired. The law was strongly attacked and as strongly defended, but by 1935 the refinancing of farm mortgage being carried out through the Farm Credit Administration had taken some of the pressures off for moratoriums on foreclosures. In 1934, there were 27.8 foreclosures per thousand farms mortgaged, while in 1936 the number had declined to 20.0. Three years later the number was 15.0.

With the refinancing program under control, the land bank system turned to the task of finding ways to straighten out the overlapping territories of national farm loan associations, later designated Federal land bank associations, and to strengthen their financial structure. The stock of over one-third of the associations was impaired.

By 1939, the land banks found many of the borrowers they and the Federal Farm Mortgage Corporation had financed were still not able to make enough progress to indicate they would be able to handle their debt load. The foreclosure rate on loans of the Federal Farm Mortgage Corporation rose.

It was at this time the Farm Credit Administration was transferred from its independent agency status to become a part of the United States Department of Agriculture. To leaders of the Farm Credit Administration, loss of independent status seemed a threat to the cooperative nature of the farm credit system. In the period between the President's message to Congress on Reorganization Plan No. I, April 25, 1939, and the actual transfer, effective July 1, 1939, protests were made to the President and to Congress.

Dissatisfied officials of the Farm Credit Administration and others who opposed the transfer were assured by Secretary of Agriculture Henry A. Wallace on May 22, 1939, that the Farm Credit Administration would not become an integral part of the Department of Agriculture. It would remain an autonomous agency except that it would report to the Secretary of Agriculture rather than to the President.

After reviewing Farm Credit Administration policies in relationship to other policies and programs of the Department of Agriculture, Secretary Wallace decided that the Farm Credit Administration as a part of the Department of Agriculture should have its functions coordinated with the other activities of the Department. Forrest F. Hill was succeeded as Governor of the Farm Credit Administration by Albert G. Black, who had been serving as the Department's Director of Marketing and Regulatory Work. The appointment of Black as Acting Governor was announced by President Roosevelt on December 20, 1939. These changes were followed by an easing of the foreclosure policy of the banks and the Federal Farm Mortgage Corporation which resulted in cutting foreclosures from 18,694 in 1939 to 9,407 in 1940. Variable payment plans geared to farm income were tried on 7,000 farms, and standstill agreements on second mortgage Federal Farm Mortgage Corporation loans were put into effect on about the same number of farm loans. The effort to resell or lease foreclosure farms to former borrowers or their relatives was increased. During World War II, a period of farm prosperity, FCA used its loan authority to help farmers make changes needed to increase production, while encouraging the paying off of earlier loans. On December 4, 1953, the Farm Credit Administration again became an independent agency.

In 1971, Congress consolidated all previous laws regarding the farm credit system into a new Farm Credit Act. The act specified that Federal Land Bank loans could not exceed 85 percent of the appraised value of the real estate offered for security. Prior to 1971, the banks could lend up to only 65 percent of the normal agricultural value of real estate. Under this legislation, the component parts of the farm credit system were able to pool capital, share losses, exchange loans, participate in loan syndications, and continue to gather funds nationwide through the sale of bonds and other debt instruments.

For many years the farm credit system was regarded as one of the most stable segments of the financial community. During the 1970's, when farmers were generally prosperous, the system increased its share of lending to the agricultural sector from 24 percent of total agricultural loans made in 1971 to 33 percent in 1981. However, as land prices began to fall in 1982, the security backing many of the loans fell to below the amounts of the loans. Too, increasing interest rates caused problems. Although legislation has set special interest rates at various times in the past, legislation in effect for many years provided that the interest rates charged should not exceed the interest rate on the last series of farm-loan bonds issued by the bank making the loan plus one percent. This meant that in a period of rapidly rising interest rates, the Farm Credit Land Banks could keep up with the increasing costs of money. However, at least in recent years, the system priced its interest rates according to the average rate it paid on its total portfolio of bonds and notes outstanding plus one percent. This helped farmers in times of inflation but was a problem for the system. By mid-1985, the Spokane and Omaha districts were in difficulty and the entire system was deteriorating. Nonperforming loans were on the increase and the demand for the system's bonds and notes eroded. These problems led to a major overhaul by Congress of the system's regulatory structure and business methods.

The 1985 amendments to the Farm Credit Act changed the organizational structure of the overseeing agency, the Farm Credit Administration, by replacing the 13-person Federal Farm Credit Board with a 3-person Presidentially-appointed Board of Directors. The Administration's regulatory powers over the system's institutions was increased. The Farm Credit System Capital Corporation was rechartered as essentially an additional bank with the responsibility for assisting system banks in financial difficulty. The amendments empowered the Secretary of the Treasury to purchase bonds issued by this Corporation up to an amount provided for by Congressional appropriations.

The amendments brought about major changes in that authority over the entire system was more centralized as contrasted with the original objective of setting up a decentralized system in which farmer members would have a major voice. The amendments also made it clear that as Congress should direct, the U.S. Treasury would be a lender of last resort to the system to ensure that it would not have to default on its outstanding bonds and notes.

The Farm Credit system is responsible for providing the credit needed for keeping America's farmers in operation insofar as that can be done. But the system is dependent upon farmers having an opportunity to make a living and to pay off their debts. The Farm Credit system, like farmers, has been caught up in a very deep downturn in the cycle of agricultural prices and returns. But because farming is cyclical in nature, we can hope that the cycle has bottomed out and is starting an upturn. It is possible, however, that the system may have to rely upon funds from the U.S. Treasury to stay solvent until the cycle moves further along the up side. If that happens, then the Farm Credit Administration will have the opportunity to do what it did in the 1930's. With Federal funds, it can help farmers survive a difficult period and thus contribute to the betterment of American life.

STATEMENT OF DEAN KLECKNER, PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. Chairman, I appreciate the opportunity to testify before this Subcommittee today. I am Dean Kleckner, President of the American Farm Bureau Federation and a hog farmer from Rudd, Iowa.

The American Farm Bureau Federation is the nation's largest general farm organization representing four out of every five farmers belonging to any farm organization.

The agricultural credit situation is an area that we as an organization have concentrated a great amount of time and resources on over the past two years, and one that will continue to be a high priority during 1987.

Mr. Chairman, you asked that we present our assessment of the problems faced by the Farm Credit System. As we see it, the System has a number of financial problems that have caused its recent losses. They are borrower flight, a high cost of money, loss of income due to nonaccruing loans, losses on loan liquidations, and a high cost of doing business. The System probably could have handled one or two of these financial problems, but is apparently incapable of dealing with all of them at once. However, unless the System alters its strategy and tries to deal with all of these problems rather than focusing on just one or two, we don't believe they will be able to make significant progress towards solving their financial problems.

The problems are as follows:

(1) *Borrower Flight.*—On December 31, 1986, the System had gross loans outstanding of $58.2 billion. That compares to $66.6 billion one year earlier and $79.8 billion on December 31, 1984. Mr. Chairman, that means the System lost over one-fourth of its volume of loans in only two years.

(2) *High Cost of Money.*—The System has a money cost problem resulting from high-priced bonds that were sold in the early 1980's. As of December 31, 1986, the System had $29.2 billion of bonds with rates of 10 percent or more with an average rate of 11.98 percent. Those bonds of less than 10 percent interest rate averaged 7.28 percent with an average interest rate for all bonds of 10.12 percent. When you compare those rates with ones recently sold by the System for 6 to 7 percent, it's easy to see why the System is in trouble.

While it may sound like "Monday morning quarterbacking", we believe the System made some poor management decisions. Two cases come to mind. First of all, there is a significant price to pay to redeem those high cost bonds early. That's because the System sold noncallable bonds rather than callable bonds, and noncallable bonds may only be redeemed early by paying a premium to the holder. In 1986 when we looked at coming to Congress for money to buy back the $29 billion in high cost bonds, USDA estimated the premium cost would exceed $3 billion. The poor management decision comes into play when we learned, Mr. Chairman, that the System chose to sell noncallable vs. callable bonds in most cases for about ½ percent interest rate break. Since the System does not have the money to redeem these bonds early, it will have a higher cost of money than its competitors.

The second management decision which has caused the System problems is their policy of average pricing to farmers. As long as interest rates continued to increase, that policy worked. It indeed allowed the System to expand its portfolio significantly by simply charging lower interest rates than other lenders. However, Farm Bureau believes marginal pricing and being competitive rather than below competition might have proved a better strategy. We had to believe that interest rates would eventually begin to fall.

(3) *Loss of Income on Nonaccruing Loans.*—On December 31, 1986, nonaccrual loans totaled just over $7 billion. That's almost 13 percent of loans outstanding. In addition, $5.7 billion were considered high-risk loans—they still accrue interest but have been identified as potential problem loans. Assuming that the System averages $7 billion in nonaccruing loans for all of 1987 and that the interest rate on performing loans is 11 percent, this represents a potential income loss to the System of $770 million in 1987.

(4) *Losses on Loan Liquidations.*—When the System chooses to liquidate loans, it generally does not recover the full amount of the outstanding balance of principal and interest. Net loan charge-offs for 1986 were $1.35 billion. Charge-offs will remain high for 1987 and 1988. While provisions for loan losses are used to cover these losses, these provisions must be restored out of current income because nonaccruing loans have been and are likely to remain at high levels.

(5) *High Cost of Doing Business.*—Much has been said about the need to restructure the System to reduce overhead costs. In 1986, the System had "other expenses" (which includes employee, occupancy and equipment expenses) of $896 million. While $896 million is a significant amount, cutting back on overhead costs will not solve the System's financial problems. Even if the System reduced its "other expenses" by 20 percent, and saved $179 million—it wouldn't make a dramatic difference when you consider the System lost $1.9 billion last year. Mr. Chairman, we don't want to ignore the possibility of the System cutting back on overhead in order to reduce expenses. Obviously since the System has lost over one-fourth of its loan volume in the past two years there is probably more overhead expense than is necessary for that loan volume. We recognize that economies of scale do exist. However, we are concerned by those who look primarily at cutting back overhead costs as a way to help the System. In fact, they are simply using that figure to help promote their plan to move the System toward a national bank holding company.

Our voting delegates recently adopted the following policy regarding the FCS. It says:

We believe that preservation of the Farm Credit System is in the long-term best interest of U.S. agriculture. We should take the lead in developing a long-term plan for its survival. Any changes in the System should adhere to the following principles:

(1) Continuation of a borrower-controlled organization;
(2) Decentralization to the maximum extent feasible;
(3) Lending limited to farmers and their cooperatives;
(4) Full disclosure of financial condition;
(5) Protection of the value of member-borrower stock;
(6) Pursuit of meaningful and effective restructuring of member-borrower loans; and
(7) Prompt infusion of federal government capital as needed.

Our policy provides us a good basis to start from in looking at which direction the Farm Credit System should move in the future. Nevertheless, there are numerous unanswered questions and a lot of "meat to be put on the skeleton". I appointed eight state presidents to an Agricultural Credit Advisory Committee in mid-December. I challenged that Committee to look at all facets of agricultural credit, but to focus first on the Farm Credit System. This Committee will make recommendations on the Farm Bureau's plan for the future of the Farm Credit System.

In summarizing our position on the Farm Credit System, I reiterate that we believe the System has to deal with all of the five problems I previously mentioned. Unfortunately, the System can't simply lower interest rates to borrowers to a competitive level. They must first deal with their problems. As Farm Bureau looks for solutions we will keep the following goals in mind:

(1) To make certain that any federal assistance provided to the System is passed on to the borrower/member. Too often in the past actions have been taken to save the System rather than the borrowers, who are the reason for the System.

(2) To protect the value of the borrower stock. I believe that was also the intent of Congress in the 1985 amendments.

(3) To obtain lower interest rates so that the System is competitive with other lenders.

(4) To keep borrowers fully aware and informed of actions taken by the System.

Mr. Chairman, I would also make one final point about agriculture's income and debt situation. The problems within the Farm Credit System seem to have intensified even as the income situation in agriculture as a whole has stabilized and improved slightly. Farm income on a net cash basis, all cash receipts to agriculture minus all cash outlays, was about $44 billion in each of 1985 and 1986 after running in the high $30 billion area for the previous few years. Current projections indicate that net cash income may be slightly higher in 1987 than in 1986.

This mildly encouraging income picture combined with a lower debt load is a sign that production agriculture is slowly but surely working its way through its debt load problems.

Agricultural debt, excluding farm households, declined from $198.9 billion on December 31, 1984 to an estimated $186 billion on December 31, 1986, a decline of 6.5 percent. During that same period of time, gross loan volume for the System is down from $79.8 billion to $58.2 billion, a decline of 27.1 percent.

The System is losing loan volume at a substantially greater rate than the overall decline of debt within agriculture and sustaining huge losses at a time when there is a ray of light in the farm income picture. The increased losses are due to factors within the System and cannot be addressed by policies that shotgun across all of agriculture. We strongly believe the issues of farm programs and farm credit, and help for the System specifically must be dealt with separately.

Farm Bureau appreciates this opportunity to discuss our views on the Farm Credit System. We will be continuing to work towards finding solutions to the System's problems and will look forward to sharing those ideas with Congress. Thank you for the opportunity to testify today.

STATEMENT OF

JACK KELSEY
PRESIDENT
OKLAHOMA FARMERS UNION

TESTIFYING ON BEHALF OF

NATIONAL FARMERS UNION

TO THE

SUBCOMMITTEE ON AGRICULTURAL CREDIT

OF THE

COMMITTEE ON AGRICULTURE,
NUTRITION & FORESTRY

UNITED STATES SENATE
WASHINGTON, D.C.

FEBRUARY 26, 1987

Mr. Chairman and Members of the Subcommittee:

I am Jack Kelsey, President of the Oklahoma Farmers Union, and I am testifying today on behalf of the National Farmers Union, a general farm organization representing the interests of over a quarter million farm and ranch families throughout the United States. Of those families, 90,000 live in Oklahoma. On behalf of the members of the Farmers Union, I appreciate the opportunity to appear before your subcommittee and share with you our thoughts and concerns about the federal Farm Credit System. I particularly want to thank Chairman Boren for inviting us to participate in this important hearing.

The bottom line is that unless the family farmer and rancher is saved, saving the Farm Credit System will make no difference. Unless the family farm system of agriculture remains, there will be no purpose for the Farm Credit System. As things stand now, farmers tell me they feel they no longer have a voice in their own Farm Credit System. That must be changed. And the core problem of farm income and repayment capability must be turned around.

There is no doubt that family farmers and ranchers in this nation continue to suffer needlessly under a policy of continually lower and lower farm commodity prices. I am here today to stress that the roots of the problems facing the Farm Credit System are the same as those facing those farm and ranch families. The underlying problem is one of farm income, not farm credit. It would be a mistake to implement some sort of rescue plan for the Farm Credit System or the nation's other agricultural lenders without at the same time acting to assure stronger farm prices and income. Unless farmers and ranchers are able to earn an income in the marketplace that allows repayment capability, the Farm Credit System will never recover and will need larger and larger and more and more frequent transfusions of federal capital.

I'd like to first outline some of the recent developments in Oklahoma's Farm Credit System institutions, then take an historic look at the previous two crises in Farm Credit history, and then look at the solution.

Despite enactment by the Oklahoma Legislature of a one-year moratorium on Farm Credit System foreclosures, the System continues to aggressively pursue these proceedings. In addition, Enid Land Bank officials have been quoted as saying they are preparing for a "massive number of foreclosure actions." We continue to hear reports that the Farm Credit Services of Wichita has instructed member institutions to foreclose a "minimum of two farms or ranches per county per month," and that "the backlog of foreclosures and other cases has so clogged Oklahoma's District Courts that a 9- to 18-month foreclosure period of Farm Credit Services is now the norm." These reports come from farmers through their Ag-Link Hotline (a statewide counseling service). Another frequent complaint heard on the hotline is that farmers who have been current in their loan payments but whose collateral has been devalued are now facing loan acceleration.

A personal friend of mine faced that situation just a year and a half ago. Due to an expensive and lingering illness in the family, he fell behind in his payments to the Federal Land Bank. He received a foreclosure notice. In the meantime, his finances took a turn for the better, and so he offered to become current in his payments and then to pay off the remainder of the loan as originally scheduled. The Federal Land Bank rejected his offer. My friend owed more than $200,000 in remaining debt. The Federal Land Bank sold that farm to someone else for $70,000.

This one illustration shows how this policy of accelerating loans and not allowing forebearance not only devastates family farmers, but the Farm Credit System as well. Just on this one farm, the Federal Land Bank lost the opportunity to recoup $130,000 and my friend lost his dream.

Not all of the news related to the Farm Credit System in Oklahoma is bad. The Farm Credit Banks of Wichita are vigorous supporters of Oklahoma's Agriculture Mediation Program. This is a low-cost collaborative program backed by the Oklahoma Commissioner of Agriculture, Oklahoma Farmers Union, and other organizations in the Ag-Link Coalition. We believe voluntary debtor/creditor mediation will offer many agricultural producers the opportunity to remain in business. This plan can be accomplished without new legislation and will not pre-empt creditors' rights. We believe it will be a real benefit for Oklahoma farmers and ranchers.

The crisis now faced by the Farm Credit System, with its loss of $1.9 billion last year, is not the first one. The system faced similar life-threatening problems from 1918 through 1925 and again from 1929 through 1932. In each case, the underlying problem was one of dropping farm income and plummeting farm buying power. In each case, a dramatic turnaround in farm commodity prices and farm income solved the problem. Restoration of an equitable farm income is the only solution for today's crisis as well.

Unless meaningful steps are taken now to bolster farm income, the crisis that began in 1981 will deepen and additional bail-outs could become addictive. Farmers, investors and taxpayers will all suffer.

There have been erroneous reports in the media that the 1986 Farm Credit System financial report is actually good news. The only good news is that the final loss of $1.9 billion is less than the previously projected loss of $2.6 billion. Good news maybe because the smaller loss might mean the Farm Credit

System's problems have bottomed out and it will rebound. I don't believe those reports.

It is not acceptable to say that the Farm Credit System will survive because there are no longer as many farmers to make demands upon it. The Farm Credit System was founded for the purpose of saving family farmers. Its intent is to serve them. Fewer farmers to be borrowers of the Farm Credit System simply points to a deeper problem. And a questionable accounting practice that allows Farm Credit System units to extend their write-off of bad accounts over 20 years is just further evidence that present farm policy is inadequate.

Let's take a broader look at the practices of the Farm Credit System in recent months. The basis for its existence is that by working together through a cooperative, farmers can provide for their financial needs. Several movements in recent months point away from this cooperative principle and need to be redirected.

First, the Farm Credit Banks of Wichita pioneered an abhorrent means of disposing of property it has acquired. The banks advertised property for sale, and offered financing at a discounted rate of interest and without requiring the accompanying cooperative stock purchase -- but only to borrowers with excellent credit ratings within the System, or to outsiders. To emphasize, the Farm Credit District decided it could violate the first principle of a cooperative: that of farmer-borrower ownership and control. Instead, it said it would lend to nonmembers at better interest rates than were available to member operators, and without requiring them to become members. Again, local farmers were not allowed a voice in the cooperative they own! In some cases, farmers who had given up the land could have survived and perhaps even turned a profit if they had been offered the same terms. But when they inquired, they were turned away as poor risks. This system of land disposal has been adopted by several other Farm Credit Districts and is under consideration in still others. We in Farmers Union believe it is morally wrong, if not illegal! It definitely violates the principles of a cooperative.

Second is the issue of farmer-borrower control of the very institutions they own. Directives from the district level or perhaps higher have instructed local Federal Land Banks and Production Credit Associations to authorize a consolidation with their sister institutions in nearby towns. In some cases across the nation when local cooperatives voted down the proposal, they were instructed to vote again until they got it "right." Some of our local PCAs and FLBs in Oklahoma have tenaciously refused to capitulate, and we applaud them. The movement toward consolidation has meant a shift in representation on the boards of directors and changes in management practices. It has resulted in the loss of more than 40 PCAs and 27 FLBs nationwide -- and those figures are a year old. It has removed cooperative participation one more step away from the farm gate.

Farmers Union must agree with Farm Credit Corporation of America President H. Brent Beesley when he says, "Only with a strong Farm Credit System can farmers be sure of a consistent supply of funds, rain or shine. Farmer ownership and control of the system is our best guarantee of that dependability."

Farmer ownership and control of the system must be restored to the local community level. Borrowers must retain their right to vote on policy matters that affect their local communities. And all borrowers must become voting members of the cooperative by purchasing stock. Preferential interest rates and stock purchase waivers to those outside the system can no longer be tolerated!

Now, to some of the proposed solutions. It has been reported in the media that one proposal is consolidation of the current 12 Farm Credit Districts into as few as six. That is a simplistic but dangerous plan to eliminate local control. Elimination of regional districts in favor of larger districts serving the nation removed decision making from system owners. As a result, the individual borrower-owner will have little chance for input, little chance for loan servicing, little chance to survive! Folks like my friend -- the fellow who lost his farm for a debt of $200,000 just so the Farm Credit System could recoup $70,000 and write off a $130,000 debt -- folks like him will have even less chance when a larger institution takes over.

Another proposal reported in the media is for the U.S. Treasury to buy the system outright, turn it around, and resell it to the private sector. That's not what Farm Credit System owner-borrowers want for their banks.

Private banks are unable to adequately serve the rural community. Non-cooperative banks are facing the same problems as the Farm Credit System. In Oklahoma, 26 banks closed last year, and six banks have shut their doors already this year. These banks were taken over by larger banks -- but the takeovers did not include more than $300 million in farm loans. These farm loans were turned over to FDIC for foreclosure. The chance of farm producers obtaining a new source of credit after FDIC foreclosure is slim at best. We expect these conditions to remain the same or worsen in 1987. There are 50 banks on the state Community Bankers Association list of problem banks. In Oklahoma, one investment group which has controlling interest in 30 banks statewide, has issued orders to all their loan officers to decline all agricultural loans. We've seen what a federal takeover of farm loans means. Clearly, a federal takeover of the Farm Credit System is no answer.

Certainly, the Farm Credit System needs assistance. Some of that assistance must come from within, some from outside, but any infusion of federal funds can only be a temporary shot in the arm. The real cure is a change in federal farm policy that allows farmers to earn a fair price and repay their loans.

There is a farm bill that will restore farm income and purchasing power while cutting government farm costs nearly in half. Improved repayment capability is vital to any of the proposed solutions. It will allow farmers to repay their loans to the Farm Credit System and other lenders. It will revitalize other basic industries as farmers begin to replace failing machinery and purchase other needed inputs. Restoring farm income is the only proven solution to Farm Credit System problems. The need is urgent. The time is now. The failed 1985 Farm Bill must be replaced by a workable plan of supply management. I believe that is the best answer to the farm income problem -- and therefore the farm credit problem.

Thank you.

TESTIMONY FOR
DAVID SENTER, NATIONAL DIRECTOR
AMERICAN AGRICULTURE MOVEMENT, INC.
ON
AGRICULTURE CREDIT

THURSDAY, FEBRUARY 26, 1987

BEFORE THE
SUBCOMMITTEE ON AGRICULTURE CREDIT
CHAIRED BY
SENATOR DAVID BOREN

Mr. Chairman and members of the Committee. The American Agriculture Movement, Inc. appreciates the opportunity to appear before you today on the important subject of agriculture credit in America's rural communities, and the severity of its existing problems.

The Farm Credit System has served agriculture well during its long years of service. While the FCS is one of the three major lenders in agriculture, with over $54.5 billion loaned to borrowers, it is suffering severe financial problems resulting from depressed commodity prices. There can be no long-term solution for the FCS or any agriculture lender until legislation is enacted to raise commodity prices above the cost of production. Nonaccrual loans continue to increase, exceeding $7 billion dollars at the end of 1986, with other high risk loans now estimated at $5.7 billion. With the System's surplus recources now drawn down to $1.45 billion, it is clear FCS must have an infusion of capital to continue services for all of 1987.

At the same time, FCS is creating some severe problems for many borrowers. Instead of practicing forebearance the FCS is pushing many borrowers into bankruptcy and foreclosure that could be avoided. Many times when borrowers are foreclosed upon, the Federal Land Banks or Production Credit Associations offer new buyers lower interest, better terms and do not require stock purchases. Many times, if the new terms were offered to existing borrowers they could reschedule and cash-flow their operations, saving everyone concerned -- including the lending institutions -- unncessary losses and maintaining a "proven" productive operation.

Better cooperaton between FCS and Farmers Home Administration would enable many borrowers to utilize available guaranteed and subordinated loans. These loans would lessen risks and protect FCS capital resourcces. Many borrowers have been forced to turn to bankruptcy as a last resort in an attempt to save their operations. Many filing under the new Chapter 12 are finding themselves without production financing for the '87 crop. We can document cases where workable Chapter 12 plans have been filed but lenders are refusing production loans. It is becoming clear that legislation to correct this problem will have to be pursued together with changes to improve both the FmHA and FCS.

The AAM fully supports retaining local control of the Federal Land Banks and Production Credit Associations by their borrowers and members. We will continue our opposition to efforts to centralize control. Unfortunately, there are those who would use these troubled times in our rural communitites to gain control of farm lending.

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STATEMENT OF GRANT B. BUNTROCK, NATIONAL FARMERS ORGANIZATION

Mr. Chairman and members of the Subcommittee, thank you for this opportunity to appear before you today. Mr. DeVon Woodland, our National President, has asked me to bring you his personal greetings and emphasize our appreciation for your arranging this hearing to address the problems of the Farm Credit System.

Since the Farm Credit Council and representatives of the Farm Credit System will testify, I will not attempt to relate numbers concerning the financial condition of the Farm Credit System.

Total loan volume to farmers and ranchers is down; the ratio of high risk loans has increased. We have another year of reported losses within the System; there is yet another increase in acquired property through foreclosure. It is easy to see that the System is in serious trouble.

The year-end financial status report would look even worse if over half of the Federal Land Banks and one of the PACs had not utilized Regulatory Accounting Practices at year end to prevent stock impairment.

Given this dismal financial status, neither the System nor the Farm Credit Administration knows whether it needs the financial assistance provided by the 1985 legislation.

The internal conflicts within the Farm Credit System, reflected by 54 lawsuits, is another problem which must be dealt with and might be resolved through financial assistance to the System.

If the System or its regulator does not take action to initiate financial assistance, it may be necessary for Congress to do so.

The Farm Credit System is only a part of the problem concerning the overall agricultural debt of $180 billion. Of the $54.6 billion in FCS loans, $5.7 billion are in the "high risk" category and nonaccrual loans increased to $7 billion by the end of 1986. As of December 31, 1986, FmHA showed total outstanding loan principal of $28.2 billion, of which $18.1 billion was in the delinquent category. Delinquencies for the remaining $100 billion of agricultural debt carried by commercial banks and other lenders are running in the 20 percent range.

From January 1 to February 24, 1987, thirty commercial banks have failed. Nine of these were classified as agricultural banks. Total projection of failed banks is estimated as high as 180 during 1987. Many of these will be agricultural banks.

FmHA currently has 1.4 million acres of farmland in its inventory as a result of foreclosures. We understand they have an inflexible policy where any loan delinquency of $100 or more requires notification of the borrower that his loan has been accelerated or called. There is no latitude by the FmHA County Supervisor or State Director to handle the situation on a case-by-case basis. This has undoubtedly resulted in the forced sale of land and increased foreclosures.

GUIDELINES FOR ACTION

The only real long-term solution for the farm debt crisis is better farm prices. While this sounds simplistic and perhaps unrealistic at this point, the truth is we would not be here today if farm producers received a reasonable price in the marketplace. While the focus here today is on the credit system, a strong commitment for improved net farm income must also be given priority if we are to work our way out of this mess.

In the meantime, steps must be taken to maintain the Farm Credit System as well as other financial institutions as a viable credit source of agriculture. However, don't bail out the investors and financial institutions unless you are going to strengthen the cash flow for individual owner-operators in the mid-range of farming.

Priority should be given to save what is left of our family farms. Refinancing, acceptance of lower interest rates under long-range terms for repayment of restructured loans and interest buy-downs for reliable producers should be given first consideration by all lending institutions.

The leasing or sale of land that has come into possession of the lending Agencies should be placed with an individual owner or operator. We would like to think that those who will control the land, the small business houses and the future of community affairs in Rural America will be people with long-standing interests in those communities.

The current emphasis by the Administration toward total FmHA loan guarantees in lieu of direct loans should be modified to include the strengthening of direct loan availability in many circumstances. Reliable people tell us there is no money available in many areas for direct loans and are referred to the Guaranteed Loan Program. As we have testified previously, local banks in many instances will not use the guaranteed program for small short-term loans because of the "red tape and paperwork required for a short-term operating loan."

We have heard discussions concerning the secondary money market as a possible external source of funding for the System. While we have not seen any specifics, we feel this could be a positive step provided it would strengthen the System through fixed or lower interest rates for borrowers. It should be studied.

We have also heard discussions concerning the separation or removal of the joint liability between Districts within the Farm Credit System. We are opposed to this.

The only chance for survival of the Farm Credit System during this critical period is to deal with the entire Farm Credit System. The separation of liability for agricultural debt within the System could eventually result in fewer Federal Land Banks and agricultural PCAs and borrowers in many areas of the country would not have access to the Farm Credit System.

In summary, the farm credit crisis must be addressed by the Congress from two fronts: 1) Immediate legislation to improve farm income in the marketplace; and 2) Take whatever steps are necessary to maintain a viable agricultural credit system which ensures that our family farms, small businesses and agricultural banks survive this critical period.

Mr. Chairman, again we thank you and the members of this Subcommittee for the opportunity to present our views. Your interest is timely and certainly it is appreciated.

STATEMENT OF LEROY WATSON, LEGISLATIVE REPRESENTATIVE, OF THE NATIONAL GRANGE

I am Leroy Watson, Legislative Representative of the National Grange, which was the first of the general farm organizations to be organized in the United States. As such, it has had a long history of involvement in issues relating to agricultural credit, in general, and the Farm Credit System, in particular. We appreciate this opportunity to present our views.

Our involvement with agricultural credit issues dates back to 1891 when the National Grange first advocated the formation of cooperative farm loan associations. Grange agitation in 1912 prompted Congressional studies of the European system of amortized long-term farm mortgages that eventually led to the Federal Farm Loan Act of 1916. Grange efforts to remove the Farm Credit Administration from partisan political control in the 1930's is the reason today that the address of the FCA is McLean, Virginia rather than 14th and Independence in Washington, D.C.

Our concerns today, however, are more recent in scope. What problems led to the two largest yearly losses of any U.S. financial institution being reported in both the 1985 and 1986 consolidated financial statements of the Farm Credit System? In presenting our views, it is not an attempt to blame anyone or any institution. We believe that no reasonably informed farm borrower, lender, or public policy maker had any way of knowing that the tremendous farm asset appreciation of the 1970's would have been followed by the disasterous agricultural equity collapse of the 1980's. The most important lesson of the last 15 years of the agricultural business cycle is that despite our best efforts to stabilize farm income, the greatest peacetime collapse of our national agricultural economy, specifically the underlying equity values that supported farm loans, occurred anyway. We would be negligent in our responsibilities to both current and future farm families, if we did not review actions by the government, the Farm Credit System, other lenders and farmer/borrowers that may have contributed to the collapse.

We believe that the major problem that put the Farm Credit System in its current distressed situation was a failure to manage risk. Starting with provisions of the Farm Credit Act Amendments of 1970 and continuing through today, the FCS, the government and borrower stockholder decisions have increased profits and market share along with risk. In my remaining time, I would like to summarize six areas where the FCS's risk management has failed, or is failing, as well as a few of our proposals to correct those situations in the future.

I. INCREASED LOAN LEVELS TO INDIVIDUAL BORROWERS

During the 1970's, the System's institutions increased their maximum loan levels to borrowers as a percent of both the underlying collateral property value and the loaning institutions. Coupled with employee compensations that were tied to loan volume, these policies helped lead to greater market share for the System, particularly in the farm mortgage market. This strategy increased the

System's profits. Furthermore, requiring smaller down payments for farmers to acquire property extended opportunities for the disadvantaged, and would allow efficient operators to start or expand their farming operations.

Against these advantages, however, smaller down payments decrease the amount of owner equity that is available to cushion land value declines. Large loans, as measured by a percent of the local Land Bank or the PCA's net worth to a few individual farmers means that the solvency of entire local associations were often at risk with a few large local farming operations. As larger loans became the norm, the System's management made more and more operating decisions (bricks and mortar, salaries and staffing, etc.) based upon the profits of larger loan volumes.

II. JOINT LIABILITY FOR SYSTEMWIDE SECURITIES ISSUED ON WALL STREET WITHOUT ADEQUATE SYSTEMWIDE STANDARDS OF ACCOUNTABILITY OR PERFORMANCE

Briefly, we believe that the System's agreements to be jointly liable for each other's obligations in the financial markets were prepared under the assumption that they would never have to be used. Their primary purpose was to assure investors, government regulators, borrowers, etc. that the System was "doing something". They were not viable risk management tools to be used by System officials to police themselves. Furthermore, given recent evidence of lawsuits and succession fights within the System as a result of the 1985 amendments, we have serious doubts that the assumed fraternal cooperation among essentially distinct and separate local member-sensitive cooperatives is, or was, possible.

III. AVERAGE COST PRICING FUNDED BY NON-CALLABLE SECURITIES BEARING INTEREST RATES THAT EXCEEDED THE AVERAGE COST OF FUNDS

Many FCS critics point to average cost pricing as a major culprit to today's current System financial crisis. They contend that marginal pricing would have been the wise management alternative. While marginal pricing (charging interest rates on farm loans based upon the current interest rates that investors charge in the financial market) would have managed interest rate risk, it is not the only way.

Average cost pricing (charging interest rates on farm loans that are based upon the average interest rates that FCS institutions are paying to investors on both current and past obligations) was not in and of itself a disasterous policy had the System's management managed the risks. Issuing Systemwide securities that contained "call" provisions when those securities had to bear interest rates that exceeded the System's interest averages would have allowed average cost loan policies to continue under basic cooperative operating principals, and would have shielded the System's institutions and borrowers from the rapid decrease in interest rates. "Call" provisions would have increased the interest costs on the securities that bear them, and to an extent, would have increased the average cost of funds and farmer interest rates more rapidly. However, we believe that legitimate risk management is a necessary provision of average cost pricing.

IV. MERGERS AND CONSOLIDATIONS, ESPECIALLY DISTRICTWIDE

System mergers, especially those designed to create large multistate district associations, are another example of policy that is profit wise and risk foolish. Districtwide mergers may or may not provide operating economies of scale. They do guarantee that failure of a districtwide association will have a broad impact over hundreds of thousands of farm borrowers in several states, over the political process and probably the U.S. Treasury, on Wall Street's financial markets, and on the rest of the Farm Credit System. Essentially, the bigger they come, the harder they fall.

V. FAILURE TO PROVIDE FOR A METHOD, OTHER THAN FORECLOSURE, FOR THE FCS TO PROTECT SECURITY INTERESTS ON PROPERTY PLEDGED AS LOAN COLLATERAL WHEN THE DEFLATIONARY MARKET OCCURRED

In the early 1980's, FCS institutions faced the problem of being the dominant lender in the agricultural credit market segment, farm mortgage and real estate loans, that was deteriorating the most rapidly. Faced with declining equity values to back up farm mortgages, lenders could either sit back and watch their unsecured exposure grow, or they could exercise preemptive foreclosures to protect what security interest they had remaining from deteriorating further. Preemptive foreclosures and sales in a declining market tend to drive land prices down further and faster and foster more foreclosures and more equity and wealth loss for family farmers. Foreclosures that are based upon protecting collateral security are economically inefficient if they displace a producer who otherwise was an efficient operator with a strong prospect of weathering the crisis. It places unnecessary and intolerable burdens on the lives of farm families who are driven from their farms. It generates tremendous social and political animosity between farmers and lenders precisely at the moment when farmers and lenders need to work together. Failure to devise a method to defer risk in the security interest underlying farm loans is probably the major market failure/government policy failure in the area of agricultural credit in the past 15 years.

VI. STOCKHOLDER/BORROWER CONTROL AND STOCK EQUITY RISK

Many farmers/stockholders have lost confidence in their cooperative lenders. In part, they blame those lenders for economic situations that are beyond their control. Rightfully, they also question the FCS's quality of information, opportunity to participate in cooperative policy making and the ability to speak, or act, as a stockholder without fear of reprisal or retaliation. Increasingly, they are turning to the political process to surrogate for their stockholder management perogative.

The 1985 Farm Credit Act Amendment provides an example. Exclusion of stock from the capital sharing provisions of the Amendments left borrowers with the impression that Congress removed their stock from risk and that the fate of their cooperative has little bearing on the fate of their stock investment. Combine an FCS that creates an image of confusion, frustration and possibly fear coupled with a political process that is eager to separate equity from risk and it is difficult to imagine an environment that is less conducive to farm/borrower/stockholder control.

We also have six recommendations to make to the Subcommittee at this time that may or may not be acted upon in conjunction with any efforts to provide government assistance to the Farm Credit System. We believe that should any government assistance become necessary for the FCS, it should be only the minimum amount that is needed and in no way alters the fundamental relationship between a local borrower and his loan officer. Nor should a loss of local control of FCS associations be a price for assistance.

1. Create a Secondary Market in guaranteed farm mortgage-backed securities, and possibly farm operating note-backed securities as well. A secondary market for farm mortgages has been proposed to increase liquidity and competition in the farm mortgage market. In addition, a farm securities market would allow Farm Credit System institutions to diversify their risk in the mortgage and operating loan market without driving efficient farm families off the land.
2. Review the agreement of joint liability to highlight the risk that individual associations place on the FCS as a whole and potentially, the U.S. Treasury. Include a review of alternatives, such as an insurance fund system.
3. Review, through the oversight process, the form and structure of FCS stockholder equity and its optium degree of risk, protection of the rights of stockholders as owners/managers and opportunities to enhance farmer/borrower/stockholder participation in their cooperative.
4. Review FCS financing and lending policies based on either marginal cost financing or average cost financing that includes provisions that are sufficient to secure against the prospect of locking-in unfavorable interest rates.
5. Discourage, for the time being, large System mergers.
6. Review FCS's lending policies to account for the general risk that increasingly large loans to individuals and increased levels of loan leveraging has on borrowers and FCS lenders.

This concludes my testimony, Mr. Chairman, and I would be happy to answer any questions that you may have.

STATEMENT OF RONALD E. VOTH, PRESIDENT, OKLAHOMA WHEAT GROWERS' ASSOCIATION

My name is Ron Voth. I am from Fairview, Oklahoma. I own and operate a diversified wheat and stocker-cattle farm. Currently, I am president of Oklahoma Wheat Growers' Association and I'm on the board of directors of the National Association of Wheat Growers.

I am speaking on behalf of myself, as both a Federal Land Bank and a production credit borrower, and the National Association of Wheat Growers.

My purpose in being here is not to blame anyone or their judgments of the past. There is enough blame to go around for everyone and this will never solve our dilemma that we face with an ailing Farm Credit System. Yet, in looking ahead at the future of this System, we also cannot avoid admitting our past mistakes nor avoid trying to correct them.

Congress and the System have attempted to address our problems these last 2½ years through various measures. Most of the attempts were well intentioned; but, in the end, the symptoms and not the problems were treated. Now farmers are faced with a System that is needed, but it is very ill. It is like a steer with pneumonia. We can see that the steer is sick and say, "well, surely he'll look better tomorrow, then we'll treat his condition." The 'morrow comes and one of two things happens. One he died: or two, we treated him and he lived with some permanent damage. None of us want the finest Credit System in the world to end like this!

As I look at my Farm Credit System, and I emphasize *my* as I am an owner of this System, we cannot, any longer, just treat the symptoms. We have to face the root problems now.

The important component of the Farm Credit System, as I understood it was founded for, was to be a reliable source of both long and short-term credit, priced competitively on sound lending principles under the control and ownership of the member borrowers. All this was for the family farmers and ranchers. Have we lost these original cooperative principles?

Many of these principles have been forgotten in today's farm credit operations. I might add that we, as borrowers and stockholders, let it get away. Lord Keynes's (a famous economist) most famous dictum was, "if you borrow 100,000 pounds from the bank and cannot pay it back, the borrower has a problem. But if you borrow 10 million pounds from the bank and cannot pay it back, the bank (or lender) has a problem."

The Farm Credit System has now gotten too top-heavy, noncompetitive, and insensitive to change. I will offer my thoughts as to where we might go from this point, both in short term and long term, and problems that must be resolved.

Our short-term and intermediate problems are (nonperforming loans, too high overhead costs in the System, large volume of high-cost securities held by the System, noncompetitive interest rates charged to our borrowers, status of borrower's stock and insolvent banks and associations).

Some questions that we need to ask ourselves are: (1) Is this System too top heavy and unresponsive to farmers needs?; (2) are we perhaps so intent on just saving the System that we are not also saving many of our best and most efficient farmers?; (3) what will happen to our commercial-size farms should this Credit System fail?; and (4) are we, as borrowers, content to let the Farm Credit System become like large central banks that are run from the top down by high paid CEO's who don't know agriculture?

Nonperforming loans are bleeding our System. We better face these loans fair and square. Foreclosure and liquidation are not the answers in many cases. Yet, when the calf is dead, it's part of the death loss and we must go on. Let's take care of those who will have a chance if given the opportunity, and many will! These farmers want to stay and pay their loans; they have been good customers.

Restructuring, reamortization, both interest and principal deferments, need to be used more aggressively. We need to ask, "Is this borrower financially responsible?" and "can and will this farmer do what is necessary to change his operation into a profitable one?" If the answer is "yes" to both of these questions, we need to work with these people to keep them by vigorously using the tools previously mentioned.

Restructuring should make an unprofitable loan profitable or it's not a viable plan. Also, the cost associated with restructuring should perhaps be picked up by the borrower at a later date. This should be the case even if and when the Federal Government needs to infuse capital into the System and this is probably a reality. We're not asking for a handout; just give us an opportunity and we will carry our share of the load.

We will never stabilize land values until we stop the many foreclosures and restructure more loans. We are on a continued self-destructive path at the present unless something changes.

High overhead is also eating up our profits. The Systems (banks, associations, Capital Corp., and FCA) cannot afford many of the luxuries of the past and present. Just as we farmers have had to cut back expenses to be efficient and productive, so the System needs to do likewise. We as borrowers are watching closely.

Our current policy on restructuring and on nonperforming loan liquidation is not working. Let our local associations make the decision as to who qualifies, and then get to work and do it.

I would be remiss if I didn't express some observations and comments concerning the Capital Corporation and the Special Asset Group they established to service nonperforming loans and to manage acquired properties. They operate outside the control and the supervision of the district banks and the association boards of directors. On the association and service-center level, this has created confusion and misunderstanding among the stockholders in the System.

Since the Special Assets Group has attracted many of the former association administrators and loan officers, it has created a shortage of experienced personnel to properly conduct the business of these associations in servicing loans of both old and new stockholders who are not yet in default and have not been assigned to the Special Assets Group. It further illustrates the need for the System to put more emphasis on developing programs to help the solvent stockholders instead of waiting till a delinquency occurs. Would it have been more feasible to have let the associations continue serving the nonperforming loans under the supervision of the Capital Corporation, thus eliminating the confusion? Misunderstandings and considerable expense have resulted from the formation of the Special Assets Group.

We need to price our interest on loans based as they were before 1971. Then bonds were sold according to the length of the loan at the prevailing interest. Averaging interest costs were great when land prices were inflating, but placed an artificial value in land. Appraisal methods and percent loaned based on these appraisals are questionable and need our attention.

If we intend to keep our good borrowers and those who are highly leveraged borrowers, interest rates for both (in real terms) must be reduced to a competitive rate as required by the original law. Somehow, we must bite the bullet and deal with both problem loans and good loans. We must reduce the interest to both, if they are to stay with the System and survive until profitability returns to agriculture. We need both types of borrowers.

Some are asking, "Why are borrowers so scared that they will lose their stock?" In simple terms, they feel it's an added cost that they would have to pay on an already shaky loan. Maybe we should apply all stock to the principal, down to a minimal level, and price our loans accordingly. Stock impairment would probably cause panic, as does a run on a bank when confidence is lost. My advice is to leave stock alone.

These functions and ideals, among others, must be retained for the Farm Credit System to move from bad to good times. Return the control of the local associations back to the local boards! The employees of the local associations and the district banks need more latitude in servicing the loans. Association paperwork in loan applications has more than tripled recently, neither to the benefit of the lender nor to the borrower. System employee morale and the turnover is less than acceptable and attention is needed.

Let's remember that the local loan officer and borrower started this relationship and it takes each one's belief, confidence, and cooperation. This is absent in many cases today. Make good sound loans based on competitive interest and sound lending principles to all borrowers, not a select few. Stockholders have specific rights as do lenders. If, and when, Government infusion of capital is necessary, it should not be part of the Ag commodity budget since this is a banking and/or Treasury-related expenditure.

More emphasis and attention needs to be given to a borrower's managerial ability (cash flow) and not to rate loans (primarily on its collateral and equity position) in determining the interest rates charged and the rating of loans.

Loyalty and confidence in any business is vital. I would remind you that there are many borrowers who are paying their loan payments with little equity in the loan: Let's not push them over the cliff. We need these loyal borrowers. We are losing borrowers at an alarming pace and this probably won't improve until the real issues (high interest, nonperforming loans, low farm income) affecting us are treated. I am confident that the Farm Credit System will survive and will be an even stronger, efficient contributor to our farmers' and ranchers' successes.

We, as a country, are backing and protecting many of our large banks. Much of this is at the cost of agriculture exports, because these debtor nations need to generate revenue to pay their debts to U.S. banks. Yet, a record number of rural banks are failing today. Were these international loans collateralized and made based on cash flow? No institution makes bad loans; times change, thus a loan viability changes. Today risk management has become a vital management consideration, and been transferred to the farmer with no assurances of a profitable return.

We as farmers need your support to help this great Farm Credit System back on its feet. But, more importantly, help for commercial family farmers to get back on their feet is vital. There is a direct correlation between farm income and a farmer's ability to service debt.

We as an organization of wheat producers are vigorously working to improve our Farm Credit System and also are working to put profitability back into the wheat industry. You can be assured that we will not sit on the sidelines in this critical period.

Thank you for your kind attention to present my thoughts to this very important Senate Subcommittee on Farm Credit.

STATEMENT OF RAY HANKES, CHAIRMAN, FARM CREDIT TASK FORCE OF THE NATIONAL PORK PRODUCERS COUNCIL

Good morning Chairman Boren and members of the Agricultural Credit Subcommittee. My name is Ray Hankes and my family and I operate a swine farm in Fairbury, Illinois. I am also a member of the NPPC Executive Board.

We are pleased to be here to testify today on behalf of the 110,000 pork producer members in 44 States. As you know Chairman Boren, Oklahoma has a sizable hog industry located mostly in the eastern part of your State. Farm Credit is vitally important to those producers, to me and to all pork producers in the United States.

The National Pork Producers Council is so concerned that we have formed a task force to consider the full extent of the problem and the solution. Mr. Chairman, we haven't had a solution or we would have offered it long before the Farm Credit System got into the problems that caused them to announce last week that the System lost 388 million dollars in the last quarter of 1986, for a total loss for the year of 1.9 billion dollars.

I serve as the chairman of the NPPC Farm Credit Task Force and we recently spent 3 days in Washington talking with Members of Congress, the Farm Credit Administration, the Farm Credit Council, the insurance industry and others about Farm Credit System and other sources of credit to the producers of food and fiber for the United States and the world.

After our fact gathering sessions we arrived at eight statements of principle and concern. All of these statements reflect the overwhelming desire of the task force members to preserve credit for agricultural borrowers. Our concern is that credit-worthy borrowers have the ability to borrow. We have lesser concerns about what that System is called, how it is structured or who administrates it. These statements of principles and concern have been formulated with intentions of developing a National Pork Producers Council policy and action plan on Farm Credit.

Mr. Chairman, next week we at the National Pork Producers Council will have our annual meeting. We will be presenting these eight statements to the delegate body for their consideration and official sanction. However the delegates will establish our official policy. Now for our statements of concern:

(1) Credit at competitive rates must be readily available to all credit-worthy agricultural borrowers.

(2) The National Pork Producers Council urges the administration and the Congress to recognize the immediate and critical nature of the Farm Credit problems and to take steps to rectify these problems with more permanent solutions.

(3) The National Pork Producers Council supports incentives to credit agencies to restructure present farmers loans rather than foreclosing on troubled loans that have a potential for repayment because of positive cash flow.

(4) The National Pork Producers Council supports the creation of a secondary market for farm mortgages, to be available to all lenders for farm real-estate loans. This increased availability of funding should reflect to the producers the greater competition in providing for credit needs, resulting in lower interest rates.

(5) The 1985 and 1986 amendments to the Farm Credit Act have not brought a resolution to the Farm Credit System problems.

(6) Any Federal aid to the FCS should be linked to a reorganization plan that would ensure long-term solutions to the FCS problems, with the primary goal of as-

sisting farmers' credit needs. Such a request for aid should be considered in a properly deliberative manner to ensure the maximum farmer input and consideration protecting borrowers equity.

(7) If a capital infusion is needed to rescue the Farm Credit System's viability, it should not be at the expense of existing agriculture programs.

(8) The Farmers Home Administration should remain as a viable source of credit, to farmers within its present lending parameters. Sufficient funding should be made available allowing the Farmers Home Administration to pick up the portion of Farm Credit needs that qualify for this program.

We will be sure to get you and the other members of the committee a full report on our Farm Credit policy and plans of action. Many of our members are only holding on by their fingertips. Before they can receive any relief the Farm Credit System needs rapid changes made in their regulations that allow our pork producers, who can maintain a proper cash flow, a chance to survive.

We also want you to know that the National Pork Producers Council stands ready to assist this committee in any way. We would be pleased to join forces with you and the committee to help put an end to the recurring nightmare that American farmers have about not being able to secure credit or maintain loans that are already in existence. Mr. Chairman, thank you again for allowing the National Pork Producers to testify today. I would be pleased to answer any questions you have.

STATEMENT OF EUGENE SEVERENS, CENTER FOR RURAL AFFAIRS, WALTHILL, NE

My name is Eugene Severens; I work for the Center for Rural Affairs in Walthill, Nebraska. The Center was formed in 1973 by rural Nebraskans concerned about the role of public policy in the decline of family farms and rural communities. Since 1978, the Center has been active in analyzing the impact of public policy in the allocation of agricultural credit. We believe that the proper role of federal policy in agricultural credit is in making modest amounts of credit more accessible to operations that have the ability to become efficient family-size operations. We have consistently taken the position that there is no legitimate reason for federal intervention in agricultural credit to make credit more available to operations that are larger than necessary to be efficient. As a result, we have been persistent critics of the open-ended emergency credit programs of the Farmers Home Administration (FmHA) and, since 1979, we have called for the congressional imposition of limitations on the wide-open lending policies of the Farm Credit System.

The 1970's will stand as a threshold decade of challenge in U.S. agriculture—the expansionist decade that sowed the seeds of the farm depression of the 1980's. Any critique of agricultural policy in the 1970's must include a fundamental re-examination of the role of public policy in debt financing in agriculture. We welcome these hearings on the Farm Credit System (FCS) as such an opportunity.

The role of debt financing in agriculture and public credit policy faced their severest test in the 1970's and 80's and have not only been found wanting, but must be indicated as part of the problem. In the case of the FCS, the failure of public policy is more by default than design, but that fact has not made it any less a failure or reduced the damage. In fact, the failure of the decades-old public policy underpinning the Farm Credit System is all the more painful because most had assumed it was a safely completed public policy success—from direct federal nurturing of Federal Land Banks in the nineteen-teens to the gradual but much heralded payback of federal seed money decades later.

We now must recognize that not only had the system gone astray, but by the sheer size of this so-called "success" it set the lending policies for agriculture in the 1970's and forced other lenders and farmers to reluctantly play the debt financing game by FCS rules.

A CASE STUDY

To get to the bottom of this failure and help this subcommittee and other policymakers avoid repeating the mistakes of the past, I would like to provide briefly some examples of FCS lending policies in Nebraska during the 1970's. Parts of Nebraska in the 1970's were a testing ground for agricultural investment and lending because the sandhills of the north central part of the state were perhaps the last large farming frontier in the country. Capital—whether through investment or debt financing—brought together enormous stretches of cheap ranchland and the new technology of center pivot irrigation to grow more surplus corn. The magic alchemy of easy debt and the new irrigation technology could turn $200/acre fragile grazing land into $1000/acre corn ground practically overnight.

This irrigation development was strenuously opposed and criticized by many who saw it as an eventual ecological disaster and a financial boondoggle. The local boards of the PCA's and FLBA's in the sandhills area were themselves opposed to many of the irrigation loans but they were overruled by the Omaha district bank. These Omaha district officials of the Farm Credit System, now newly weaned from its federal creator, defied the critical analysis and helped make sure that the boondoggle became a reality. The results were not only the predictable ecological disaster (which federal taxpayers must now pay to correct) and the inevitable financial boom and bust, but also the eventual destruction of two Nebraska PCA's and permanent critical financial injury to every single owner-member of those PCA's.

What are the ingredients of this failure? Without going into all the details, our analysis of the financial troubles and eventual forced liquidation of two sandhills PCA's points to several basic problems that point toward the need for future reforms:

—an uncritical and unprofessional faith that land prices would perpetually inflate beyond farmland's earning potential and thereby serve as collateral for any manner of loan;

—disregard for the healthy, conservative lending practices espoused by the local association boards;

—allowing a disproportionate amount of an association's loan portfolio to go to one or two high-rolling investor-farmers;

—effective abandonment of eligibility criteria which limited lending to owner-operators in favor of the meaningless criterion of "bona fide farm owner"—an open-ended eligibility criteria that allowed loans to farmland investors.

Mr. Chairman, much more could be said along these lines, but I would like to use the rest of my time to bring to the subcommittee's attention a way to address the inevitable FCS bailout in a way that restores integrity to a system that is now bankrupt in vision as well as financially.

FSC BAILOUT AND FAMILY FARM REBUILDING

Historically, the most successful federal agricultural credit program has been providing modest loans funds for individuals to build up efficient family-size farm units. This basic concept was behind the original creation of the federal land banks 70 years ago; it was the basis of the Bankhead-Jones Act in the Depression; and it finds its current manifestation in FmHA's Farm Ownership (FO) program. Components of the approach include: limiting loans to efficient, family-size operations; limiting the amount of the loan to a modest amount; and protecting the government's investment by fully securing the loan by the property being purchased.

So what does that have to do with bailing out the Farm Credit System (FCS)? As is generally acknowledged, the FCS is in need of an emergency infusion of federal funds, and it happens to own about $1.2 billion worth of farmland in its growing inventory—land that can be sold to infuse cash into the system. If Congress responds to the need for a fund infusion, what better way to design that infusion than by providing FO-type direct loans to eligible family-size borrowers to purchase FCS farms. For lack of a better term we call the loans envisioned by this concept "FO/FCS loans."

The use of this FO loan approach to the sale of FCS inventory has a number of advantages:

It provides a needed infusion of funds to the FCS. While probably not enough to respond to the total potential loan losses faced by FCS, it's a start and a policy-sound way to buy more time to assess the system's progress.

The infusion starts with family farmers and works its way up. Unlike some forms of direct federal transfusion to the top of the system, this infusion starts at the base of the system and percolates up—eventually to the bondholders.

The plan would be automatically targeted to distressed associations and district banks facing the biggest loan losses since those institutions would probably have the largest inventories and sell the most farmland under this approach.

The plan would create new or re-entry farming opportunities and help usher in the rebuilding phase of the farm crisis. This plan would serve the long-standing proven public purpose of providing new farming opportunities for new operators and for current operations to rebuild back to efficient family-size farms.

The plan can be quickly and simply implemented by channeling the funds through FmHA's current direct FO program but earmarking the FO purchases to farmland acquired by FCS-institutions. While we have reservations about FmHA's commitment to the public purposes delegated to it by Congress, we think there is broad consensus for bailing out the FCS, and if FmHA mechanisms provide a sound way to direct that bailout, then the agency would respond favorably. Certainly, there is no denying that FmHA has the county-level delivery system and long experience in administering this type of loan.

The plan would help stabilize land prices in three ways: by helping reduce the size of the inventory which looms over the land market; by increasing the demand for land by adding a new set of buyers (including previous owners) into the land market; and the plan could preempt the FCS land dumping programs that have already begun in at least one FCS district.

The public investment is safer since it is not a direct investment in the uncertain future of the FCS, but an investment in and fully secured by farmland that is being sold at prices that are now in line with the land's earning power. The public investment is dispersed in farmland throughout the country and not held hostage by the future recovery of the FCS.

The plan can be designed to rejuvenate local association membership by encouraging borrowers to shift from the special FO/FCS loans to straight Federal Land Bank loans when the borrower is capable of "graduating" from the FmHA loan.

The plan can be designed with provisions that allow for the recapture of any interest subsidy (such as might be available through the FO program's limited resource interest rate) in the event that the purchased land appreciates sufficiently in value.

Mr. Chairman, I think this approach has some merit both in providing an infusion of funds into the Farm Credit System, but, just as importantly, in re-establishing proven public purposes in agricultural lending. This same basic approach of using FO-type family farm loans to buy down inventory land could be applied to lenders other than the FCS. For example, it could also be developed as a guarantee program, which would turn the liability of an inventory farm into a loan asset on a commercial banks' balance sheet. While helping lenders with their problems in a direct and immediate way, the approach would be doing double duty by opening up farm rebuilding opportunities to "post-crisis" family farms. Thank you for this opportunity to provide testimony.

STATEMENT OF LUMAN W. HOLMAN, ON BEHALF OF GRASSROOTS: THE NATIONAL ASSOCIATION OF FARM CREDIT SYSTEM STOCKHOLDERS AND THE FEDERAL LAND BANK ASSOCIATIONS OF TEXAS STOCKHOLDERS' DEFENSE FUND

My name is Luman Holman. I am from Jacksonville, Texas and appear today on behalf of Grassroots: the National Association of Farm Credit System Stockholders ("Grassroots") and on behalf of the Federal Land Bank Associations of Texas Stockholders' Defense Fund ("Defense Fund"). I am Executive Director of Grassroots and Chairman of the Tyler Federal Land Bank Association.

Grassroots was organized by farmer/rancher borrowers of the Farm Credit System and has representation from each of the 12 Farm Credit Districts. It is composed of PCA people, Land Bank people and people interested in cooperatives. The Defense Fund represents farmer/rancher borrowers from 42 of the 44 Land Bank Associations in Texas.

The aim of these shareholder organizations "is to encourage farmer- and rancher-borrowers' participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit. . . ." I have just been quoting from the "Policy and Objectives" section of the Farm Credit Act itself. I want my citation to these words of the Congress to show this Subcommittee that the shareholder groups that I am speaking for today want to preserve the Farm Credit System as Congress founded it.

The problem is not with Congress or the stockholders, who, I believe, see eye-to-eye. The problem is with the Farm Credit Administration and with the "System's" top management. Mr. Chairman, as you yourself said on the floor of the Senate, on October 17, 1986:

"Despite the fact that thousands of farmers are being foreclosed this year by the system, the system has expressed no desire for legislation to prevent the massive foreclosures. Further, the system has failed to come forth with any meaningful restructuring program to keep producers in business.

"In the 1930's when massive foreclosures were taking place, interest rates were reduced, across the board, to 4.5 percent for old and new loans. A special fund was set up to make 'rescue' loans. These actions resulted in providing more than 760,000 farmers with loans, thereby keeping these farmers in business. Today, regretfully, system officials have expressed no interest in providing this kind of assistance.

"The system apparently doesn't see its purpose as keeping farmers in business anymore. Like many large organizations, the Farm Credit System appears to have become a bureaucracy interested only in perpetuating itself."

Especially in today's difficulties, shareholder groups need the system to stay alive and carry out its essential farm credit functions in a sound and responsible manner, while preserving the local control and management that are the hallmarks of a truly cooperative system.

The Congress has worked very hard to pass two relief acts, the Farm Credit Amendments of 1985 and the Farm Credit Amendments of 1986. Why have those Acts given so little redemption and relief to stockholder/borrowers and System institutions?

The first culprit is the Farm Credit Administration. FCA has continually defied the Congress and acted to thwart effective system self-help and to drive all system institutions to the brink of capital impairment or beyond.

In June 1986, FCA promulgated regulations to implement the provisions of the 1985 Farm Credit Act amendments giving assessment powers to the Farm Credit System Capital Corporation. Ignoring the specific congressional mandate that those regulations protect the viability of the remaining healthy lenders in the system, FCA's regulations allowed the assessment and seizure of every last dollar of every system institution, saving only capital stock. Since these regulations were plainly designed to destroy the ability of all system institutions to function as viable lenders: i.e., to make credit available on reasonable terms at competitive rates, numerous institutions were forced to seek judicial protection. FCA and the Capital Corporation have now been enjoined by several Federal Courts from enforcing those assessment regulations. I attach the opinions of Federal Judges in Massachusetts and Texas holding the FCA's actions in violation of Congress' statutes.

In October 1986, when Congress passed emergency legislation to permit the use of regulatory accounting procedures in lieu of GAAP, from July 1, 1986, taking into account loan loss situations back to the first of the year, Congress again was acting to conserve the resources of viable lenders. FCA, however, has taken a highly restrictive approach to regulations under the 1986 amendments and as a result is unnecessarily increasing pressure on all system institution balance sheets. FCA's continuing hostility to letting viable Farm Credit System lenders continue making credit available to farmers on reasonable terms is in direct conflict with Congressional directives that FCA's approach to loss sharing and assistance to the most troubled lenders must strive to avoid impairment of viable lenders.

I can only interpret the apparent eagerness of FCA to drive every system lender into "Zone D" nonviability at the earliest possible date as evidence of its complicity in the drive to centralize all authority in a one-bank system, as I will explain in just a moment.

The point is that FCA's refusal to protect the dwindling viability of the system's remaining institutions forces litigation and creates the appearance that the "have" banks are not willing to share with the "have not" banks. The reality is, however, that hundreds of millions of dollars have been shared among system institutions. The simple fact is that the demands of FCA's assessments and regulations transgress and circumvent the law, as several courts have declared.

The other culprit is the system's own top management—our employees—who want to replace the present decentralized structure with a single "central entity." Make no mistake about it. The real agenda of the top management of the Farm Credit System is the waging of a relentless, ceaseless and self-serving effort to destroy the Farm Credit System as a decentralized system of banking cooperatives.

Let me draw your attention for a moment to the document attached to my testimony. This document is an August, 1986 communication from Grant Lucas, the Chairman of the Farm Credit Corporation of America ("FCCA"), one of the "service organizations" chartered by the Farm Credit System. The FCCA document is a resolution stating that the Farm Credit System should adopt, in place of its current structure, a single, national super bank to service the entire country. And, lest anyone think that they want to achieve this end through voluntary action, their implementation plan recommends the use of the Capital Corporation "as a tool to facilitate the accomplishment of the plan." After public exposure, we are told that another vote rescinded the adoption of the plan—but the fact that so elaborate a scheme was surfaced and publicized in late 1986 tells you where these men still are, for they are the proteges of those who originally proposed "Project 1995" to create a super-bank, something you, Mr. Chairman, have addressed on the floor of the Senate.

I believe that the actions of FCCA and others who want to force merger throughout the system are in shameless and ruinous defiance of the most basic tenets of cooperative, borrower ownership on which Congress founded this system.

There is certainly a continuing crisis on the farm. The ability of farmers to secure credit grows more and more difficult. This problem, of course, deserves the attention that it is receiving in Congress, and your thoughtful attention to the problem, Mr. Chairman, is longstanding and your leadership genuinely appreciated.

The System's present organization is a good one. Thirty-seven banks, using private capital, and owned by local farmer-rancher stockholder-borrowers, supply one-third of this nation's overall agricultural credit on the basis of local knowledge and local conditions. The system belongs to its borrower-stockholders, and we do not need it to be refashioned to fit the grand dreams and schemes of an employee-management that wants its hands on the helm of a super bank.

One need only look at the capital markets today to see that this system is continuing to raise money within a very small spread over the government's own cost of funds. The capital market does not believe that this system has to be run through a central entity in order for investors to receive a return on system bonds.

Again I do not say that there is no credit problem in American agriculture; but the farmers' credit problems are not the result of the Farm Credit System's cooperative form, and employee-management should not be permitted, even with FCA complicity, to use the crisis in agriculture as an excuse for taking our local Farm Credit System institutions away from us. FCA's wanderings down this path have led it into a litigation quagmire that has tied the agency and the Capital Corporation in a knot; Congress will have to untie the knot with new legislation. This time let there be no room for the centralizers to try to thwart the will of Congress and deny the stockholder-owners of the system real relief. Congress must craft and construct legislation that will guarantee that farm credit relief becomes a reality.

Grassroots held a meeting in December in Des Moines, Iowa, attended by representatives from each of the 12 Farm Credit Districts to discuss new legislation. The consensus we reached was that any comprehensive Farm Credit System legislation in the 100th Congress should include the following points:

1. maintaining and emphasizing borrower ownership and control in a Farm Credit System that will remain decentralized;

2. reemphasizing the System's original mission to provide farmers, ranchers, and agricultural cooperatives with sound, adequate, and constructive agricultural financing;

3. providing for a meaningful program of forbearance and loan restructuring to help borrowers at the local level, including lease-back authority in local associations to avoid placing acquired property on the market;

4. protecting borrower stock to the maximum extent possible;

5. creating a meaningful program for self-help in the system that will work, by restructuring the Capital Corporation or otherwise;

6. reaffirming that borrowers who are subjected to mistreatment, misinformation, coercion and forced merger can sue for judicial protection if necessary;

7. acting in time to save the System's remaining healthy institutions from being reduced by FCA's Congressionally unauthorized and excessive efforts to the point that they can no longer keep themselves from needing outside assistance;

8. acting to sunset the Farm Credit Corporation of America, and to hasten the sunset of the Capital Corporation in its present form—a sunset already provided by Congress in the 1985 Act; and

9. maintaining decentralization necessary for informed local decisionmaking and management, including a right in stockholders of any district bank by majority vote to have a separate board of directors for that bank if they so desire.

In addition, we believe that Congress should enact a strengthened Borrowers Bill of Rights if the Farm Credit System management continues its refusal to adopt such provisions voluntarily. These protections for borrowers would include:

(1) The right to a meaningful and defined forbearance policy by the Farm Credit System, including a right of appeal within the Farm Credit System of a denial of forbearance.

(2) At least 30 days written notice before a foreclosure action is filed against a borrower of the Farm Credit System, with an opportunity for the borrower to get current on his loan, in which case foreclosure proceedings would not be filed.

(3) An opportunity for a meaningful appeal of a decision to file a foreclosure action within the Farm Credit System before legal foreclosure proceedings are filed.

(4) A borrower of the Farm Credit System should be able to have access to significant documents in his loan file at the Farm Credit System including the Farm Credit System's current and prior appraisals of his real estate and/or other assets.

Finally, let me say that if during this Congress it becomes necessary to utilize appropriated tax dollars to aid system institutions, it will be imperative for this Congress to make sure that that does not become an excuse for refashioning System banks and institutions into a "central entity" or diminishing shareholders' ownership. Indeed, if federal funds are needed, they should be lent directly by the Treasury to the individual banks in the System on the basis of demonstrated need.

In conclusion, Mr. Chairman, let me thank you on behalf of the members of Grassroots for your noteworthy and exceptional leadership in the Congress in protecting the cooperative principles on which the Farm Credit System was founded and once prospered. Thank you.

[The following material was submitted by Luman Holman in support of his oral presentation:]

STRUCTURE STUDY REPORT OF THE PRESIDENTS PLANNING COMMITTEE EXECUTIVE COMMITTEE

This report is prepared pursuant to Farm Credit Strategic and Business Plan Objective 3—Systemwide Strategy a. This report contains assumptions, concepts, alternatives and analyses regarding the future structure of the Farm Credit System. This report outlines five structure alternatives and is intended to provide a basis for discussion by the full President Planning Committee (PPC) at a meeting to be held on July 16–18, 1986.

The PPC understands that issues regarding structure must be decided by the system directors and owners. The purpose of the July meeting of the PPC is to develop useful information and alternatives for the system directors and owners to facilitate their discussion of these matters and to enhance their decisionmaking process.

The Presidents Planning Committee Executive Committee (PPCEC) organized a work group of system experts to advise the PPCEC on these matters. The work group was chaired by Don Shiflet, Baltimore. Other members were: Bud Batchelor, Columbia; John Feldmeir, St. Louis; Mike Fletcher, Jackson; Dennis Johnson, St. Paul; Jim Pierson, Springfield; Clive Sanders, Sacramento; and Mike Frey, FCCA (liaison). The efforts of the work group are much appreciated, and their suggestions have been incorporated throughout this report. The work group recommended an alternative that is somewhat similar to Alternative B-1 of this report. However, the PPCEC did not endorse the work group's recommendation. The work group was not asked to endorse this report by the PPCEC.

I. BASIC PRINCIPLES

The PPCEC considers that the following basic principles should drive structural changes:

A. *Competitiveness*—The system should be structured to provide both quality services and competitive prices over the long run. Serving member needs should be the highest priority.

B. *Local control*—The system should be structured to provide borrower control of the local associations and the central entity.

C. *Efficiency*—The system should be structured to eliminate duplication, redundancy, excessive overhead and to maximize economies of scale.

D. *Survival*—The system should be structured to avoid or minimize the need for Federal financial assistance. The efficient use of available capital and surplus is an important driving principle.

E. *Managerial Control.*—The system should be structured to allow management to control the day-to-day operations of the system and to provide uniformity and consistency in system operations.

F. *Reduce Regulatory Burden.*—The system should be structured to reduce the involvement of the regulator in the management and policymaking of the system and to reduce the overall cost of regulation.

II. GENERAL CONCEPTS AND ASSUMPTIONS

The PPCEC considers that these basic concepts and assumptions apply to each of the five structure alternatives included in this report:

A. Structural Concepts

1. Structural changes should occur on a voluntary basis and/or through the Farm Credit System Capital Corporation.

2. The process for structural changes should be designed to minimize potential disruption in the field and to accommodate associations and/or banks that are unwilling to participate in change.

3. The process for initial changes in structure should be commenced without the necessity for new legislation.

4. The major focus for consolidation and increased efficiency is on the bank and district level. Generally, functions and decisions that pertain to credit and borrower relations should be handled at the local level. Most other functions and decisions should be handled at the national level.

5. Two or more districts are consolidated in each alternative into "regions." There would be between three and six regions each comprised of two or more districts. (The alternatives shown assume five districts for discussion purposes only.) Districts should not be divided in the short run. Attachment 1 shows recommended boundaries assuming three, four, five and six regions.

6. The structure and functions at the local level are essentially the same in all alternatives shown.

7. Total assets of the system during the planning horizon are expected to be in the $50-$60 billion range.

8. The operational cost savings due to the proposed changes may exceed $300,000,000 per year. Attachment 2 is the initial cost/benefit analysis of each alternative.

9. The concepts contained in the A.D. Little Farm Credit System Structure Study were seriously considered and are incorporated herein. Attachment 3 is the Final Report of the A.D. Little Study.

10. Legislation regarding structure should not be sought unless legislation is otherwise going forward.

11. The Farm Credit Council remains an independent and integral part of the Farm Credit System.

B. Delivery System

1. The member is served at the level which optimum customer service and responsiveness can be generated (depending on the nature and needs of the member).

2. Authority is delegated to the lowest level of the organization commensurate with the skills required to serve the members' needs.

3. Member marketing applications reside at the level of customer contact including new product identification and market intelligence.

4. Oversight, EDP operations, legal and other support functions are regionalized to achieve maximum efficiency and effectiveness based on national direction and standards.

5. Policy direction, capital management, strategic planning, quality control standards, funding and system spokesperson is at the national level.

C. Ownership/Capital

1. Stock investment is made at the appropriate level and re-invested upward to the national level.

D. Governance

1. Voting stockholders elect directors of their respective institutions.

2. Association directors and cooperative stockholders elect the majority of directors to the regional board. The regional board may elect some outside regional directors. The regional board elects the majority of directors to the national board.

3. Central entity directors may elect some outside directors to the national board.

4. The national board elects directors of subsidiary entities.

5. The regional banks or offices employ association CEO's subject to approval of the associations' boards of directors.

6. The central entity employs regional CEO's subject to approval of regional bank or offices' board of directors.

7. Regional boards may remove association board members, and regional bank CEO may remove association CEO's for cause or failure to follow system policies.

8. The national board may remove regional board members, and central entity CEO may remove regional bank CEO's for cause or failure to follow system policies.

9. Association boundaries may be adjusted by the regions.

10. Regional boundaries may be adjusted by the national board.

III. ALTERNATIVES

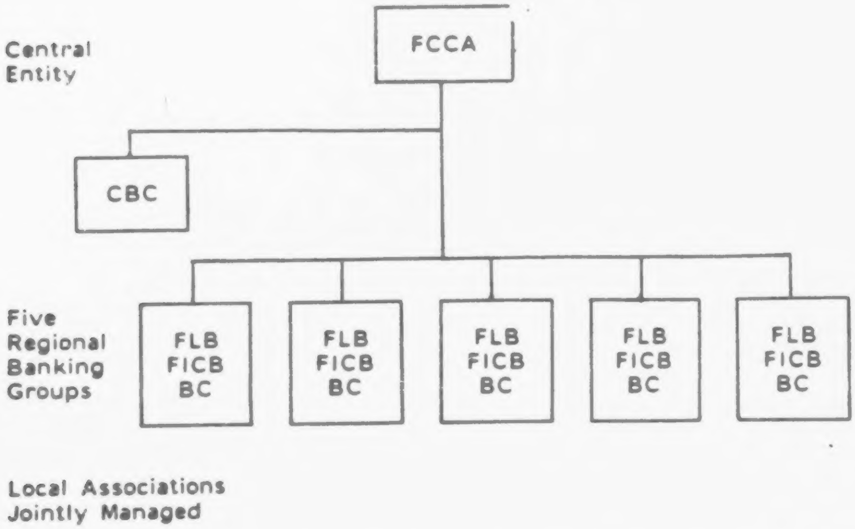
Point A is defined as the status quo:

Banks	37
PCA's	168
FLB Associations	279
Service Entities	4
Trade Association	1

Point B is defined as the range of interim structural alternatives that can be accomplished without new legislation. With some exceptions Attachment 4 provides detail on interim Alternatives B-1, B-2, and B-3.

Point C is the range of structural alternatives that can be accomplished with new legislation. Attachment 5 provides detail on Alternatives C-1 and C-2.

ALTERNATIVE B-1 (15 Regional Banks plus CBC and FCCA)

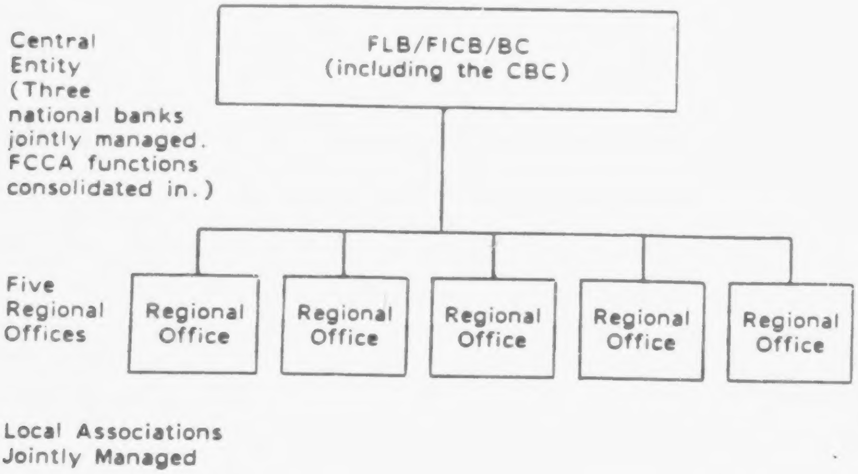

Central Entity
FCCA
CBC
Five Regional Banking Groups
FLB FICB BC
FLB FICB BC
FLB FICB BC
FLB FICB BC
FLB FICB BC
Local Associations Jointly Managed

1. Assumes banks invest capital in FCCA. This has potential legal and regulatory problems (see attachment 6).

2. Capital pooling and managerial control would be by agreement.

3. Reverse holding company concept.

ALTERNATIVE B-2 (Three banks - No FCCA)


Central Entity (Three national banks jointly managed. FCCA functions consolidated in.)
FLB/FICB/BC (including the CBC)
Five Regional Offices
Regional Office
Regional Office
Regional Office
Regional Office
Regional Office
Local Associations Jointly Managed

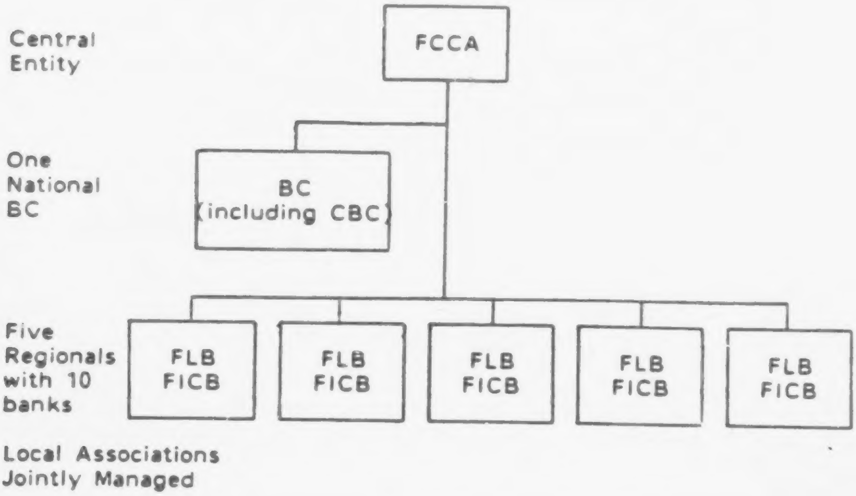
1. Assume three national banks under joint management become the "central entity." FCCA and CBC are merged in or dissolved.

2. Capital pooling among three banks would be through agreement.

3. Regional offices are administrative arms - not separate corporate entities.

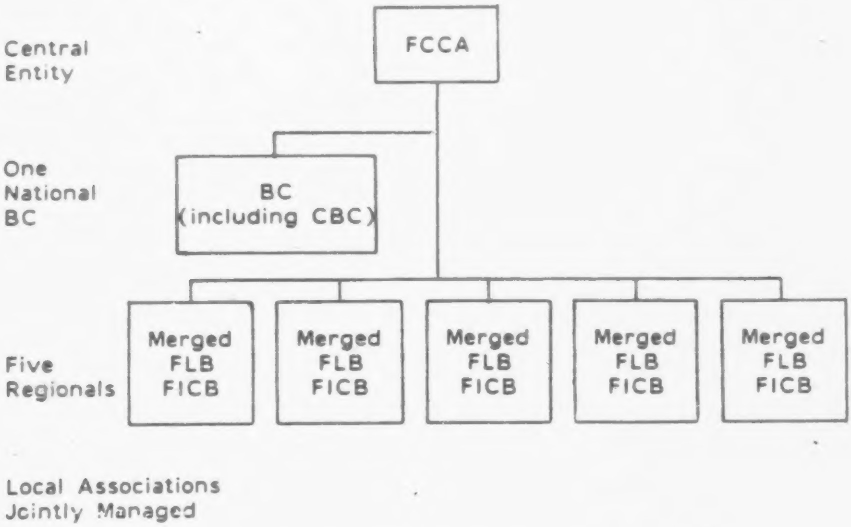
4. Reverse holding company concept.

ALTERNATIVE B-3 (11 banks plus FCCA)


Central Entity
FCCA
One National BC
BC (including CBC)
Five Regionals with 10 banks
FLB FICB
FLB FICB
FLB FICB
FLB FICB
FLB FICB
Local Associations Jointly Managed

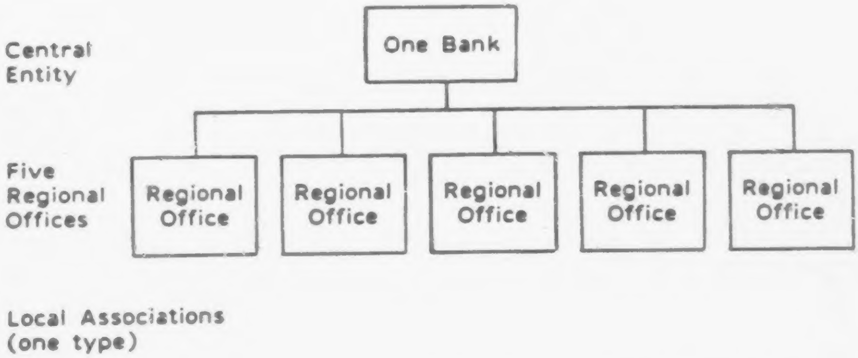
1. Same as Alternative B-1 except for a National BC. BC services would be provided through national, regional and local offices as business needs require.

ALTERNATIVE C-1 (Five banks plus National BC and FCCA)


Central Entity
FCCA
One National BC
BC (including CBC)
Five Regionals
Merged FLB FICB
Merged FLB FICB
Merged FLB FICB
Merged FLB FICB
Merged FLB FICB
Local Associations Jointly Managed

1. Same as B-3 only FICBs and FLBs merge at the regional level.

ALTERNATIVE C-2 (One bank, no FCCA)


Central Entity
One Bank
Five Regional Offices
Regional Office
Regional Office
Regional Office
Regional Office
Regional Office
Local Associations (one type)

1. Same as B-2 only unlike entities merge at the local and national level.

Implementation of Alternative B-1 and/or C-1:
1. The appropriate number of boundaries of the regions should be established.
2. Banks within two or more districts would merge on a voluntary basis or be merged by the Capital Corporation as assistance is required according to the plan.
3. The merged banks (and other banks which have not elected to consolidate) would enter into a series of agreements regarding capital, control, management, etc.

4. PCA's and FLBA's would consolidate as required to meet the business plan objectives. Where possible, these would be jointly managed.

5. All branches that are not expected to be profitable in the reasonable future would be closed.

6. The service entities would be owned by the remaining banks.

7. The Capital Corporation should be used as a tool to facilitate the accomplishment of the plan.

8. When legislation is obtained, alternate C-2 would be implemented.

Implementation of Alternative B-2 and/or C-2:

1. The appropriate number of boundaries of the regions should be established.

2. The BC's (including the CBC), FICB's and FLB's would consolidate into three banks on a voluntary basis or be merged by the Capital Corporation as assistance is required.

3. The merged banks (and other banks which have not elected to consolidate) would enter into a series of agreements regarding capital, control, management, etc. (The national BC board would be subject to the policies of the other bank boards on non-BC issues.)

4. The three national banks would be jointly managed. (Top management could be a team of three of four presidents similar to Citicorp years ago.)

5. In effect, the three banks would become the defacto "Central Entity" until the law is changed. (FCCA would be dissolved and its functions assumed by one or more of the three banks.)

6. Three to five Regional Service Offices of the three national banks would be established.

7. CPA's and FLBA's would consolidate as required to meet the business plan objectives. Where possible, these would be jointly managed.

8. All branches that are not expected to be profitable in the reasonable future would be closed.

9. The service entities would be owned by the three national banks.

10. The Capital Corporation should be used to facilitate the accomplishment of the plan.

11. When legislation is obtained, Alternative C-2 would be implemented.

Implementation of Alternative B-3:

Same as B-1 only the various BC's would merge with each other and with the CBC on a voluntary basis.

IV. LEGAL CONSIDERATIONS

Attachment 6 is a preliminary report of certain legal considerations of the structural alternatives.

V. ADVANTAGES OF STRUCTURAL CHANGE

Attachment 7 lists the criteria for measuring the advantages of structural change to owners and borrowers.

UNITED STATES DISTRICT COURT

DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 86-0214-F

FEDERAL LAND BANK OF SPRINGFIELD, FEDERAL INTERMEDIATE CREDIT BANK OF SPRINGFIELD, SPRINGFIELD BANK FOR COOPERATIVES, FEDERAL LAND BANK OF TEXAS, FEDERAL INTERMEDIATE CREDIT BANK OF TEXAS, AND TEXAS BANK FOR COOPERATIVES, PLAINTIFFS

v.

FARM CREDIT ADMINISTRATION AND FARM CREDIT SYSTEM CAPITAL CORPORATION, DEFENDANTS

ORDER

February 17, 1987

FREEDMAN, C.J.

For the reasons stated in the accompanying Memorandum issued this date, the Court DECLARES:

(1) that the regulations adopted by the Farm Credit Administration at 51 Fed. Reg. 21332 (June 12, 1986), to be codified at 12 C.F.R. § 611.1142(h), are contrary to section 4.28G(a)(15) of the Farm Credit Act, and thus are invalid;

(2) that said regulations were adopted in violation of the rule-making requirements of the Administrative Procedure Act, 5 U.S.C. § 553, and thus are invalid; and

(3) that any required purchases or assessments imposed pursuant to 12 C.F.R. § 611.1142(h) by the Capital Corporation are invalid.

The Court orders:

(1) that defendants are permanently enjoined from taking any action pursuant to said regulations, including but not limited to requiring System institutions to purchase the Capital Corporation's capital stock and debt obligations and assessing System institutions for Capital Corporation operation expenses; and

(2) that plaintiffs shall receive their costs herein.

Therefore, the Court hereby ALLOWS plaintiffs' motion for summary judgment, DENIES defendant Farm Credit Administration's cross-motion for partial summary judgment, and DENIES defendant Farm Credit System Capital Corporation's cross-motion for summary judgment.

It is So Ordered.

FRANK H. FREEDMAN,
Chief United States District Judge.

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, LUBBOCK DIVISION

CIVIL ACTION NO. CA-5-86-202

CAPROCK-PLAINS FEDERAL LAND BANK ASSOCIATION OF PLAINVIEW; FEDERAL LAND BANK ASSOCIATION OF AMARILLO; FEDERAL LAND BANK ASSOCIATION OF BRADY; FEDERAL LAND BANK ASSOCIATION OF BROWNWOOD; FEDERAL LAND BANK ASSOCIATION OF BRYAN; FEDERAL LAND BANK ASSOCIATION OF CHILDRESS; FEDERAL LAND BANK ASSOCIATION OF CLEBURNE; FEDERAL LAND BANK ASSOCIATION OF COLEMAN; FEDERAL LAND BANK ASSOCIATION OF CORSICANA; FEDERAL LAND BANK ASSOCIATION OF DALHART; FEDERAL LAND BANK ASSOCIATION OF DAYTON; FEDERAL LAND BANK ASSOCIATION OF DENTON; FEDERAL LAND BANK OF EDINBURG; FEDERAL LAND BANK ASSOCIATION OF HASKELL; HIGH PLAINS FEDERAL LAND BANK ASSOCIATION OF PAMPA; FEDERAL LAND BANK ASSOCIATION OF HILLSBORO; FEDERAL LAND BANK ASSOCIATION OF KERRVILLE; LA GRAND-BELLVILLE FEDERAL LAND BANK ASSOCIATION OF BELLVILLE; FEDERAL LAND BANK ASSOCIATION OF LAMESA; FEDERAL LAND BANK ASSOCIATION OF LEVELLAND; FEDERAL LAND BANK ASSOCIATION OF LITTLEFIELD; FEDERAL LAND BANK ASSOCIATION OF MASON; FEDERAL LAND BANK ASSOCIATION OF MCKINNEY; FEDERAL LAND BANK ASSOCIATION OF MULESHOE; NORTH CENTRAL TEXAS FEDERAL LAND BANK ASSOCIATION OF BRECKENRIDGE; FEDERAL LAND BANK ASSOCIATION OF PARIS; FEDERAL LAND BANK ASSOCIATION OF ROBY; RED RIVER FEDERAL LAND BANK ASSOCIATION OF VERNON; FEDERAL LAND BANK ASSOCIATION OF SHERMAN; FEDERAL LAND BANK ASSOCIATION OF SONORA; SABINE RIVER FEDERAL LAND ASSOCIATION OF SULPHUR SPRINGS; FEDERAL LAND BANK ASSOCIATION OF SAN ANGELO; SOUTH CENTRAL TEXAS FEDERAL LAND BANK ASSOCIATION OF SAN MARCOS; FEDERAL LAND BANK ASSOCIATION OF SOUTH TEXAS AT KENEDY; SOUTHWEST FEDERAL LAND BANK ASSOCIATION OF DEVINE; FEDERAL LAND BANK ASSOCIATION OF SPUR; FEDERAL LAND BANK ASSOCIATION OF TEMPLE; FEDERAL LAND BANK ASSOCIATION OF TYLER; FEDERAL LAND BANK ASSOCIATION OF UVALDE; FEDERAL LAND BANK ASSOCIATION OF WACO; WESTERN FEDERAL LAND BANK ASSOCIATION OF MARFA; AND WESTEX FEDERAL LAND BANK ASSOCIATION OF DIMMITT, PLAINTIFFS

v.

Farm Credit Administration and Farm Credit System Capital Corporation, defendants

CIVIL ACTION NO. CA-5-86-98

Amarillo Production Credit Association, plaintiff

v.

Farm Credit Administration and Farm Credit System Capital Corporation, defendants

CIVIL ACTION NO. CA-5-86-106

Bryan Production Credit Association; Central Texas Production Credit Association; Canadian Production Credit Association; Cattleman's Production Credit Association; Coleman Production Credit Association; Corsicana Production Credit Association; East Texas Production Credit Association; Lubbock Production Credit Association; North Texas Production Credit Association; Plainview Production Credit Association; Richmond Production Credit Association; Rolling Plains Production Credit Association; Stephenville Production Credit Association; Texas Production Credit Association; Uvalde Production Credit Association; Waco Production Credit Association; Wichita Falls Production Credit Association; Production Credit Association of South Texas; Tyler Production Credit Association; Marfa Production Credit Association; Sweetwater Production Credit Association; and El Campo Production Credit Association, plaintiffs

v.

Farm Credit Administration, and Farm Credit System Capital Corporation, defendants

MEMORANDUM OPINION

On the 3rd day of October, 1986, a hearing was held in Lubbock, Texas, on plaintiffs' motion for a preliminary injunction. After considering the pleadings, the briefs filed by all parties and *amici curiae*, argument of counsel, and the evidence submitted, the court files this memorandum opinion in support of its order granting plaintiffs' motion for a preliminary injunction. This memorandum shall constitute the court's findings of fact and conclusions of law with respect to the preliminary injunction.

Plaintiffs assert that the provisions of the 1985 Amendments (Public Law 99-205, 99th Congress, S. 1884, Dec. 23, 1985) to the Farm Credit Act authorizing defendants to compel transfers of plaintiffs' funds and equities to the defendant Capital Corporation are unconstitutional because those provisions grant the defendants the power to take plaintiffs' property for private purposes. Alternatively, plaintiffs contend that this allowance for compulsory transfers constitute a taking of plaintiffs' property without just compensation in violation of the Fifth Amendment to the Constitution of the United States. Further, plaintiffs challenge the 1985 Amendments as constitutionally invalid for failure to provide either equal protection or due process of law in the deprivation of plaintiffs' property.

Plaintiffs charge that the regulations (51 Fed. Reg. 21332, to be codified at 12 C.F.R. §§ 611.1142(h), *et seq.*) promulgated to implement the 1985 Amendments are invalid because they ignore statutory guidelines imposed by Congress in the Act itself. Additionally, plaintiffs accuse defendants of failure to follow required notice and comment procedures in the adoption of the final regulations. Thus, plaintiffs seek a judgment declaring these regulations invalid.

Plaintiffs, alleging that they are likely to succeed with their challenges to the 1985 Amendments to the Farm Credit Act and the regulations implementing those amendments, assert that they will suffer irreparable harm if defendants are not enjoined from enforcing them. Defendants, on the other hand, oppose the motion for a preliminary injunction. They contend that plaintiffs have not shown a likelihood of success on the merits. Defendants assert that granting a preliminary injunction will disserve the public interest and that the harm the Farm Credit System will suffer if an injunction is imposed will far outweight any loss to these plaintiffs should relief be denied.

As outlined in this court's order dated October 10, 1986, the court is not convinced that plaintiffs have shown a probability of success with their attack on the constitutionality of the 1985 Amendments. However, the plaintiffs have demonstrated that they are likely to succeed with their charge that the regulations implementing these amendments are invalid because the regulations permit the employment of measures in excess of Congress' express limitation and because of the failure of defendants to comply with notice and hearing requirements. In addition, plaintiffs have presented convincing evidence that they will suffer irreparable injury in the absence of a preliminary injunction. The court finds that the balance of harm to be suffered by plaintiffs if an injunction is not entered outweighs any potential loss to the defendants and the other system institutions as a result of granting an injunction. Moreover, the public interest will best be served by imposing a preliminary injunction in this case.

THE CONSTITUTIONALITY OF THE AMENDMENTS

Facing financial distress in the farming industry, in 1916 Congress created the Farm Credit System, a program which has experienced varying degrees of success. Seventy years later the viability of that system is threatened. In 1985 Congress enacted amendments to the statutory framework of the system. These amendments, designed to alleviate the economic pressure on the system, give the Farm Credit Administration ("FCA") authority to charter a new corporation empowered to marshall the resources of the entire system and its institutions by utilizing system assets first in addressing the losses being sustained by the system.

The 1985 Amendments provide a mechanism for involuntary intrasystem transfers. The past structure permitted voluntary transfers, but did not authorize involuntary assessments of the individual institutions. The producton credit associations ("PCA's") and federal land bank associations ("FLBA's") claim that the power to order involuntary transfers via required purchases of equities in the newly created Capital Corporation is unconstitutional.

The focus of plaintiff's argument that the amendments are unconstitutional is that the mandatory purchases violate the protection afforded them by the Fifth Amendment. Plaintiffs charge that the required purchases result in a taking of their private property either for a private use or without just compensation. Either effect, when caused by governmental action, is prohibited.

The defendants attempt to refute plaintiff's challenges by stating that there is no taking of property of the institutions. Alternatively, defendants contend that any taking of property is for a public purpose not for private use. Defendants describe the impact on plaintiffs' property with various euphemistic phrases. Defendants depict the proposed transactions as a "redistribution of assets," "restricted use of assets," "marshalling of resources," and a mere bookkeeping entry or paper transaction. They paint the resulting effect on plaintiffs as a "reduction of liquidity." Whatever nice words are used the bottom line is that plaintiffs will be forced to transfer dollars, which they either have or must borrow, to an infant corporation of wholly unknown value. The possibility of loss to plaintiffs is much greater than the probability that stock or bonds or obligations issued by the recently chartered organization will ever be worth anything.

With the smoke screen aside, the issue is can Congress constitutionally choose this solution to the farm credit system crisis. The question for this court is not whether further taxation and complication of an overburdened system is an effective remedy. This court is not convinced that plaintiffs will prevail in their challenge to the statutory framework based upon a fifth amendment violation or their other charges of unconstitutionality. Although the court recognizes that plaintiffs are not liklely to ever recoup anything other than pieces of paper in exchange for any money sent to the Capital Corporation, after due consideration, the court is persuaded that the statutory amendments will probably pass constitutional scrutiny, but it is not the intent of the court to determine the constitutionality of this Congressional Act at this stage of the case. That decision must await the outcome of a trial on the merits.

THE LEGALITY OF THE REGULATIONS

Plaintiffs contend that the regulations promulgated to implement the amendments must be declared unlawful because they ignore statutory guidelines. Plaintiffs also charge that the regulations are void because they were adopted in violation of the Administrative Procedure Act's ("APA's") notice and comment requirements. 5 U.S.C. § 553.

Defendants respond that the regulations are consistent with the amendments and that the regulations provide a rational and reasonable framework for the assessments and required purchases. As to the alleged procedural irregularities, defendants reply that the regulations fall within the scope of the exception of 5 U.S.C. § 553(b)(B). This court is unpersuaded by defendants' rationale. The court finds that plaintiffs will likely succeed in their challenge of the legality of the regulations on one or both of these grounds.

The regulations on their face violate the clearly expressed intent of Congress. The agency's blatant disregard for safeguards imposed by statute cannot be endorsed by the judiciary. While the regulations purport to require the agency to consider certain financial factors impacting the individual institutions, consideration of the factors actually has no effect on the resulting assessment.

The factors Congress directed the agency to evaluate are delineated at section 4.28G(a)(15) of the Amendments. 12 U.S.C. § 2216f(a)(15). Congress stated that the

> criteria *shall* provide for an equitable sharing . . . by taking into account (I.) the relative financial strength and ability to pay of the contributing institutions; (II.) the effect, *including* the effect on loan interest rates, on current borrowers and members of each system institution; and (III.) the effect on lending rates of financial assistance already provided to other system institutions.

12 U.S.C. § 2216f(a)(15)(B).

> (I.) the capital strength, earning capacity, loanable funds and overall financial viability of each System institution . . . are maintained at such a level that credit *shall* continue to be available to eligible borrowers on reasonable and competitive terms, (II.) each bank *shall* continue to have access in the public financial markets, and (III.) each bank is able to maintain adquate financial resources to satisfy its liability. . . .

12 U.S.C. § 2216f(a)(15)(B)(ii). (Emphasis added.)

The "deemed" findings established by the regulations sweep away the safeguards Congress provided. For example, if an institution has a positive level of loanable funds, then any assessment or required purchase is "deemed" not to have an effect upon the capital strength, earning capacity, loanable funds, or the financial viability necessary to provide credit on reasonable and competitive terms. 12 C.F.R. § 611.1142(h)(6)(ii). Other conclusive presumptions are drawn in subsections (h)(6)(i) and (iii). These regulations simply do not provide for an analysis of the effect of an assessment on an institution at all.

In addition, the agency by-passed procedural guidelines in issuing the regulations. Agencies endowed with rulemaking authority are required to follow the law in the promulgation of regulations. 5 U.S.C. § 553. Congress has determined that minimal due process demands that the regulating agency provide regulated parties with notice of an an opportunity to comment on the proposed regulations. 5 U.S.C. § 553(b). Recognizing that certain circumstances would justify setting aside the notice and comment requirements, Congress provided a "good cause" exception that permits by-passing that procedure. 5 U.S.C. § 553(b)(B). The exception can be invoked by the regulating agency itself. However, when the statutory procedure is not followed, the agency is required to explain why following the A.P.A. is either "impractical, unnecessary, or contrary to the public interest." *Id.*

The FCA's statement that following public rulemaking procedures is "impractical, unnecessary, and contrary to the public interest" is accompanied by the notation that "the Act requires that the regulations be in effect before the Corporation can exercise all of the power" conferred upon it and by reference to the congressional directive that the Corporation be chartered within 60 days of enactment of the Amendments and be operational as soon as possible. 51 Fed. Reg. 21334 (June 12, 1986).

The court is not impressed with the self-serving justification of agency action nor is it satisfied that the emergency conditions necessary to invoke the "good cause" exception exist.

Without a detailed analysis of the merits of this issue, it is sufficient at this stage to state that the court finds that plaintiffs probably will be able to establish the illegality of the regulations on one or both of the bases alleged.

IRREPARABLE INJURY

Plaintiffs present evidence in the form of oral testimony and affidavits from the officers of the P.C.A.'s and land banks that describe the effect enforcement of these regulations will have upon the institutions. These witnesses all state that enforcement of these regulations will result in loss of loan volume, increased interest rates, increased cost of operation, lack of ability to borrow money to meet legitimate business needs of their own institution, "borrower flight," and lower quality loans (assets). In the first hearing plaintiffs painted a picture of ultimate devastation of these institutions. At the second hearing, in an attempt to retract the scene of total system or institutional failure, plaintiffs refer to the same factors, but draw less bleak conclusions. Emphatically stating that neither institutional nor system ruin is impending, still plaintiffs show evidence of irreparable injury.

Defendants counter that plaintiffs offer only speculation about not factual documentation of potential deterioration.

The court finds that plaintiffs will suffer irreparable injury not simply compensable monetary damage if no injunction is granted.

BALANCE OF HARM

The harm to be balanced in the instant case is the injury plaintiffs will suffer if no injuction is granted weighed against any damage that may befall the defendants, who represent the Farm Credit System, if an injunction is entered. If no injunction is entered, the plaintiffs must comply with the new regulations. The individual institutions will be compelled to meet the assessments and required purchases from existing or borrowed funds. The effect of those transfers might vary from bank to bank; however, the court is satisfied that the potential for ultimate deterioration of now healthy institutions is not merely speculative. Defendants, on the other hand, must find alternate measures to assist those banks these regulations were designed to save. However, other means of handling the current situation are available. (*See* legislative history presented by both parties.)

The court finds that the potential irreparable injury to plaintiffs in the absence of injunctive relief outweighs the damage that defendants may incur if an injunction is granted.

PUBLIC INTEREST

The public interest in this case is in the lawful administration of Congressional intent and in protection against arbitrary usurpation of authority wherever it may occur in government. Although these defendants may have had no malevolent motivation in enacting these regulations, nevertheless, the role of the court is to provide the necesssary checks and balances in our system to assure the public that neither the legislative or executive branches exceed lawful bounds. Therefore, the court finds that granting a preliminary injunction in this case will best serve the public interest.

Accordingly, a preliminary injunction has been entered enjoining defendants from enforcing the regulations pending a final resolution of this case.

The Clerk shall furnish a copy hereof to each attorney in each case.

Entered this 15th day ~~of~~ October, 1986.

HALBERT O. WOODWARD,
Chief Judge, Northern District of Texas.

UNITED STATES DISTRICT COURT

DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 86-0214-F

FEDERAL LAND BANK OF SPRINGFIELD, FEDERAL INTERMEDIATE CREDIT BANK OF SPRINGFIELD, SPRINGFIELD BANK FOR COOPERATIVES, FEDERAL LAND BANK OF TEXAS, FEDERAL INTERMEDIATE CREDIT BANK OF TEXAS AND TEXAS BANK FOR COOPERATIVES, PLAINTIFFS

v.

FARM CREDIT ADMINISTRATION AND FARM CREDIT SYSTEM CAPITAL CORPORATION, DEFENDANTS

MEMORANDUM

February 17, 1987

FREEDMAN, C.J.

I. INTRODUCTION

The Farm Credit System is a national network of federally-chartered farm lending institutions. In December 1985 Congress enacted the Farm Credit Amendments Act of 1985 ("1985 Amendments Act"), Pub. L. No. 99-205, 99 Stat. 1678, in response to a severe financial crisis gripping the Farm Credit System. The 1985 Amendments Act authorizes federal aid to the Farm Credit System, but only if necessary after the stronger Farm Credit Banks have assisted the weaker banks through compulsory, intra-System fund transfers. These "self-help" transfers are to be administered by a new federally-chartered entity, the Farm Credit System Capital Corporation ("Capital Corporation"), pursuant to regulations promulgated by the Farm Credit Administration ("FCA"). The FCA is the federal agency responsible for regulating the Farm Credit System.

This lawsuit challenges the regulations which the FCA subsequently promulgated in purported implementation of the "self-help" provisions of the 1985 Amendments Act. 51 Fed. Reg. 21332 (June 12, 1986), to be codified at 12 C.F.R. § 611.1142(h). Plaintiffs, six Farm Credit System institutions, argue that the regulations conflict with the 1985 Amendments Act, and that the regulations were adopted in violation of the notice and comment requirements of the Administrative Procedure Act ("APA"), 5 U.S.C. § 553(b), (c).[1] Plaintiffs seek a declaration that the regulations are unlawful, and an injunction against their enforcement until they are rewritten in compliance with the 1985 Amendments Act and the APA.

Defendants, the FCA and the Capital Corporation, maintain that the regulations are consistent with the 1985 Amendments Act. They concede that the regulations were promulgated without providing notice and opportunity for comment, but contend that there was "good cause" for waiving these procedural requirements. Moreover, defendants assert that the claims of five out of the six plaintiffs are not ripe for adjudication, and that this Court therefore lacks subject matter jurisdiction over those plaintiffs' claims.

This matter is presently before the Court upon the plaintiffs' motion for summary judgment,[2] the FCA's cross-motion for partial summary judgment, and the Capital Corporation's cross-motion for summary judgment. For the reasons described below, the Court reluctantly concludes that the challenged regulations are procedurally and substantively invalid and therefore void. In addition, the Court finds that the claims of all six plaintiffs are ripe. The Court will allow plaintiffs' motion and will deny defendants' motions.

II. LEGAL AND FACTUAL BACKGROUND

A. The Farm Credit System

In 1916 Congress created the Farm Credit System, a national network of privately owned banks and associations providing credit to the nation's agricultural producers. In establishing this System, Congress sought to ensure that the nation's farmers and ranchers would have a continuing, dependable source of credit at competitive rates. The Farm Credit System has become essential to American agriculture; at the end of 1985, it had approximately $73 billion in outstanding loans, representing approximately one-third of all agricultural debt in the United States. Through the Farm Credit Act of 1971, Pub. L. No. 92-181, 85 Stat. 583 (codified as amended at 12 U.S.C. § 2001 *et seq.*), Congress modernized and consolidated farm credit law and reaffirmed its commitment to ensure a permanent system of credit responsive to the needs of agricultural producers. Subsequent amendments, including the 1985 Amendments Act, have been designed to maintain the utility of the System in a changing credit and farming environment.

The Farm Credit Administration examines, supervises, and regulates the Farm Credit System. The FCA does not, however, make, subsidize, insure, guarantee, service, restructure or foreclose upon System loans. Borrowers obtain credit directly through the approximately 450 banks and associations in the System.

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[1] In their complaint, plaintiffs also alleged that the regulations violate the Taking and Due Process Clauses of the fifth amendment; however, plaintiffs no longer raise these allegations.

[2] The following have filed briefs as *amici curiae* in support of plaintiffs' motion for summary judgment: Springfield and Texas Districts Farm Credit Associations; the Federal Land Bank of Baltimore, the Federal Intermediate Credit Bank of Baltimore, and the Baltimore Bank for Cooperatives; the Federal Land Bank of Columbia, the Federal Intermediate Credit Bank of Columbia, and the Columbia Bank for Cooperatives; the Federal Land Bank of Sacramento, the Federal Intermediate Credit Bank of Sacramento, and the Sacramento Bank for Cooperatives; and the State of Vermont.

There are twelve Farm Credit Districts in the United States. Each contains a Federal Land Bank ("FLB"), which makes long-term agricultrual loans through Federal Land Bank Associations ("FLBA's"); a Federal Intermediate Credit Bank ("FICB"), which provides short and intermediate-term credit through Production Credit Associations ("PCA's"); and a Bank for Cooperatives ("BC"), which makes loans directly to cooperatives. Thus, a borrower who obtains a Farm Credit System loan does so through the local FLBA, PCA or BC in the borrower's district. Plaintiffs in this case are the FLB's, FICB's, and BC's of the Springfield and Texas Districts.

Farm Credit System members are owned and controlled, directly or indirectly, by their borrowers. Each borrower is required to purchase stock or participation certificates in the lending institution as a precondition to getting a loan. But although they are autonomous and locally-oriented, the Farm Credit System banks and associations are also interdependent and financially interrelated in a number of ways. Perhaps the most important tie binding together the System's institutions is the banks' joint and several liability on the Farm Credit System securities, which are the primary source of System financing. 12 U.S.C. § 2155. Financial assistance agreements between System members further reinforce System interdependence.

B. Current Financial Crisis

The Farm Credit System is facing a severe financial crisis. Due to plummeting farmland values, the instability in the export market, expensive production costs, low commodity prices and high interest rates, American agriculture is in the midst of its worst depression since the 1930's. The impact of the agricultural depression upon the Farm Credit System has been devastating.

> During the third quarter of 1985, the 37 Farm Credit banks lost $552.5 million, the second largest loss ever recorded for any financial institution. The costs of carrying nonearning assets and provisions to absorb $3 billion or more in projected loan losses will result in multibillion dollar net operating losses in the System for the next several years. A stream of such bad news raises serious concern that investors may abandon the market for Farm Credit System securities.

H.R. Rep. No. 425, 99th Cong., 1st Sess. 7, *reprinted in* 1985 U.S. Code Cong. & Admin. News 2587, 2594.

The severity of the agricultural crisis varies in different regions of the nation. Due to a stronger farm economy, particularly in the Springfield District, and conservative lending practices in both districts, the Springfield and Texas Districts are currently among the strongest in the Farm Credit System. As of August 31, 1986, the Springfield banks and associations had total unallocated retained earnings [3] of $135 million; as of June 30, 1986, the Texas institutions had approximately $302 million in unallocated retained earnings. Reflecting their financial strength, during the past two years the Springfield and Texas banks have provided approximately $120 million in financial aid to beleaguered Farm Credit System members, pursuant to voluntary intra-System capital preservation agreements. These contributions have reduced plaintiffs' unallocated retained earnings and have raised plantiffs' lending rates.

C. The 1985 Amendments Act

Responding to the financial crisis afflicting the Farm Credit System, Congress passed the 1985 Amendments Act.[4] President Reagan signed this legislation into law on December 23, 1985. The 1985 Amendments Act authorizes a "backup" federal line of credit for the Farm Credit System, to be furnished only if necessary after the resources of the stronger System institutions have been tapped through a "self-help" mechanism established to provide assistance to the weaker institutions.

To implement this "self-help" mechanism, Congress directed the FCA to charter the Farm Credit System Capital Corporation, not later than sixty days after the enactment of the 1985 Amendments. Section 4.28A(1) of the Farm Credit Act of 1971, as amended by section 103 of the 1985 Amendments Act, 12 U.S.C. § 2216(1). Congress authorized the Capital Corporation to "require other institutions of the Farm Credit System, through purchase of stock in, or obligations of, the Capital Corporation, to make funds available to the Capital Corporation to enable it to make financial assistance available to institutions of the Farm Credit System as provided in [section 4.28G(a)(15)]." Section 4.28G(a)(14), 12 U.S.C. § 2216f(a)(14). Under section 4.28G(a)(15), the Capital Corporation is to "administer financial assistance under regulations" to be promulgated by the FCA. These regulations must:

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[3] Unallocated retained earnings equals net worth less (1) the par value of capital stock and (2) undistributed earnings that have been allocated to an institution's members or patrons.

[4] Congress recently enacted further amendments to the Farm Credit Act of 1971. Farm Credit Act Amendments of 1986, Pub. L. No. 99-509, §§ 1031-37, 100 Stat. 1874, 1877-79. In part, this legislation permits Farm Credit System institutions to change their accounting procedures to allow amortization of current losses over a period not to exceed twenty years. Congress intended this provision as a supplement to the 1985 Amendments Act. *See* H.R. Conf. Rep. No. 1012, 99th Cong., 2d Sess. 230, *reprinted in* 1986 U.S. Code Cong. & Admin. News 3868, 3875.

> (A) include standards to ensure that, consistent with sound business practices and subject to the criteria established under subparagraph (B) of this paragraph, the available capital and reserves of System institutions are committed to providing financial assistance to those institutions of the Farm Credit System eligible therefor. The term "available capital and reserves," as used in this subparagraph, shall not include capital stock, participation certificates and allocated equities held by borrowers that are not associations chartered under this Act;
>
> (B) establish criteria pursuant to which the Capital Corporation shall require other institutions of the Farm Credit System, through the purchase of stock in, or obligations of, the Capital Corporation to make funds available to the Capital Corporation under paragraph (14). Such criteria shall—
>
>> (i) provide for an equitable sharing of the burden of such assessments or purchases, taking into account (I) the relative financial strength and ability to pay of the contributing institutions; (II) the effect, including the effect on loan interest rates, on current borrowers and members of each System institution; and (III) the effect on lending rates of financial assistance already provided to other System institutions; and
>>
>> (ii) be designed to ensure that (I) the capital strength, earning capacity, loanable funds and overall financial viability of each System institution providing funds to the Capital Corporation are maintained at such a level that credit shall continue to be available to eligible borrowers on reasonable and competitive terms, (II) each bank shall continue to have access to funds in the public financial markets, and (III) each bank is able to maintain adequate financial resources to satisfy its liability on its own obligations and on that portion of systemwide notes, bonds, debentures, or other obligations for which it is primarily liable. . . .

Section 4.28G(a)(15); 12 U.S.C. § 2216f(a)(15).

If System "self-help" remedies fail to alleviate the financial crisis, then the Secretary of the Treasury may, in his or her discretion, purchase obligations issued by the Capital Corporation to provide funds to be used to assist the Farm Credit System. Section 4.28J(a), 12 U.S.C. § 2216i(a). As conditions of such purchases, Congress required certification by the FCA that:

> (1) the Farm Credit System is in need of financial assistance to address financial stress of System institutions, (2) the System has committed its available capital surplus and reserves to address such financial stress of System institutions, (3) the salaries and benefits of the senior executive officers of System institutions (except associations) will be frozen, . . . and (4) the System has used such capital surplus and reserves to the extent that further contributions from, or losses incurred by, System institutions likely will preclude such institutions from making credit available to eligible borrowers on reasonable terms. . . .

Id.

D. The Implementation of the 1985 Amendments Act

In passing the 1985 Amendments Act, Congress had expressed its sense "that the pressing needs of the Farm Credit System and the United States agricultural industry require the implementation of this Act as soon as practicable." 1985 Amendments Act § 403, 99 Stat. 1710. On February 14, 1986 the FCA issued Capital Directive No. 1, establishing guidelines for minimum levels of capitalization for all System banks and associations and protecting against the dissipation of System resources. On February 24, 1986 the FCA chartered the Farm Credit System Capital Corporation. The FCA promulgated on March 10, 1986 regulations governing the organization, operation and capitalization of the Capital Corporation, and standards under which Farm Credit System institutions may be eligible for financial aid under the 1985 Amendments Act. Plaintiffs challenge neither Capital Directive No. 1 nor the March regulations.

On June 12, 1986 the FCA promulgated the regulations required by section 4.28G(a)(15) of the 1985 Amendments Act, establishing criteria for required purchases of Capital Corporation obligations and assessments by the Capital Corporation. 51 Fed. Reg. 21332, to be codified at 12 C.F.R. § 611.1142(h). It is these regulations that plaintiffs challenge.

The relevant portions of the June regulations are as follows:

The FCA defines the assets subject to assessment by the Capital Corporation—an institution's "available capital and reserves"—as (in most cases) being equivalent to an institution's "unallocated retained earnings." 12 C.F.R. § 611.1142 (h)(1)(iii). "Unallocated retained earnings" is itself defined as "the undistributed earnings of an institution that have not been allocated to the institution's members or patrons." Section 611.1142(h)(1)(viii). This represents the surplus earnings of an institution, less capital stock, participation certificates, allocated equities and an allowance for loan losses. *See* Needham affidavit ¶ 7.

An institution's "unallocated retained earnings percentage" is calculated by dividing its unallocated retained earnings by its total assets. Section 611.1142(h)(1)(ix). This percentage is then used to place the institution in one of four "zones," dubbed "Zone A" through "Zone D," which have been developed by the FCA. System members falling in Zone A are the financially strongest members of the Farm Credit System. Those in Zone B have substantial unallocated retained earnings, but less than Zone A institutions. Institutions in Zone C have still less unallocated retained earnings, and those in Zone D are at the threshold level of capital stock and allocated earnings, with very little unallocated retained earnings. *See* section 611.1142(h)(5); Appendix 1 to section 611.1142(h); Needham affidavit ¶¶ 6–13.

The heart of the June regulations is contained in section 611.1142(h)(6), entitled "Funding Criteria." This section provides:

> To the extent necessary to fund its purchase of assets from System institutions and to enable the [Capital] Corporation to extend direct financial assistance to eligible institutions, the Corporation shall assess or require System institutions to purchase obligations to the full extent of their available capital and reserves, as defined in this subpart. In equitably distributing the burden of such assessments as they are made from time to time, the Corporation shall require institutions which . . . are classified in Zone A, B, or C to provide funds to the Corporation, prior to making assessments of or requiring the purchase of obligations by institutions classified in Zone D. The Corporation shall take into consideration the criteria contained in paragraphs (h)(6) (i) through (iii) of this section, provided that nothing in this paragraph shall prevent the Corporation from assessing or requiring an institution to purchase obligations when it has available capital and reserves.
>
> (i) The Corporation shall consider the effect that obtaining funds will have on the institution's loan rate. Any assessments and purchases of obligations shall be deemed to have no effect on the lending rates of the following institutions that either have sufficient resources to pay assessments and purchase obligations without raising their interest rates or that charge rates below the average loan rates of similar institutions:
>
> (A) Institutions classified in Zone A or B; and
>
> (B) Institutions classified in Zone C that charge an average loan rate, based on the most recent quarterly financial statement, that is below the weighted average loan rate charged by all institutions chartered under the same title of the Act and classified in Zone C.
>
> (ii) The Corporation shall ensure that the earnings capacity, loanable funds, and overall financial viability of an institution providing funds to the Corporation are not reduced by such action below the level necessary to enable the institution to provide credit to eligible borrowers on reasonable and competitive terms. Any assessment or required purchase of obligations shall be deemed to have no impact on an institution for purposes of this paragraph if such institution has a positive level of adjusted loanable funds.
>
> (iii) The Corporation shall ensure that System banks that provide funds to the Corporation retain their ability to obtain funds in public financial markets and to satisfy their individual liability on obligations. Any assessment or required purchase of obligations shall be deemed to have no impact on an institution for purposes of this paragraph if the institution is able to satisfy the collateral requirements contained in section 4.3 of the Act.

In issuing the June regulations, which were effective the day after publication, the FCA provided neither prior notice nor opportunity for public comment.[5] The FCA gave the following explanation for its decision to forgo notice and comment:

> The agency has determined that in light of the congressional directive in the [1985 Amendments Act] that the [Capital] Corporation be chartered within 60 days of the enactment of the 1985 Amendments and be operational as soon as possible thereafter, public notice and publication for comment are impracticable, unnecessary, and contrary to the public interest.

51 Fed. Reg. 21334.

On August 27, 1986 the Capital Corporation issued a preliminary notice of proposed assessment and required purchase of obligations to all Farm Credit System banks and associations, and requested specific financial data to determine each institution's level of contribution, *i.e.*, each institution's zone classification. Plaintiffs commenced this action shortly thereafter.[6] On September 15, 1986, the Capital Corporation issued a final notice of assessment and required purchase of obligations to certain System members. The total required purchase of obligations and assessments was approximately $300 million; of this amount, 99.5% was for required purchase of Capital Corporation obligations, with the remaining 0.5% assessed for Capital Corporation operating expenses. Of the six plaintiffs, however, only one—Texas Bank for Cooperatives—received a final notice of assessment and required purchase of obligations. Texas BC's share of the total assessment was $6,444,725. None of the remaining five plaintiffs—Federal Land Bank of Springfield, Federal Intermediate Credit Bank of Springfield, Springfield Bank for Cooperatives, Federal Land Bank of Texas and Federal Intermediate Credit Bank of Texas—were assessed or required to purchase obligations by the Capital Corporation.

III. ANALYSIS

A. Jurisdiction and Venue

Plaintiffs bring this action pursuant to section 417(a) (13) of the Farm Credit Act of 1971, 12 U.S.C. § 2252(a)(13), as added by section 201 of the 1985 Amendments Act; the judicial review provisions of the Administrative Procedure Act, 5 U.S.C. §§ 701–06, and 28 U.S.C. § 1331. Venue is proper in this district under 28 U.S.C. § 1391 (b), (c), and (e).

B. Ripeness

The defendants have raised a threshold issue of ripeness. They maintain that this Court should dismiss this case with respect to the five plaintiffs which have not received a final notice of assessment and required purchase from the Capital Corporation. The claims of these plaintiffs, defendants assert, are not ripe; hence, this Court lacks subject matter jurisdiction over these five plaintiffs.

In *Abbott Laboratories* v. *Gardner* 387 U.S. 136 (1967), and its two companion cases, *Toilet Goods Association, Inc.* v. *Gardner*, 387 U.S. 158 (1967), and *Gardner*, v. *Toilet Goods Association, Inc.*, 387 U.S. 167 (1967), the Supreme Court outlined the ripeness doctrine in the context of judicial review of administrative action. The "basic rationale" of the ripeness doctrine, the Supreme Court stated, "is to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements over administrative policies, and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties." *Abbott Laboratories*, 387 U.S. at 148–49. A court's role, when faced with a ripeness challenge, is "to evaluate both the fitness of the issues for judicial decision and hardship to the parties of withholding court consideration."*Id.* at 149.

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[5] On August 18, 1986 the plaintiffs, together with the FLBA's and PCA's in the Springfield District, submitted to the FCA comments arguing that the regulations violated the 1985 Amendments Act and the Administrative Procedure Act.

[6] This is one of several lawsuits brought nationwide challenging the June regulations, and, in some cases, the 1985 Amendments Act as well. *Compare Federal Land Bank of Baltimore* v. *Farm Credit Admin.*, No. H-86-3137, slip op. (D. Md. Oct. 31, 1986) (preliminary injunction entered); *Sikeston Production Credit Ass'n* v. *Farm Credit Admin.*, No. S86-0147C, slip op. (E.D. Mo. Oct. 21, 1986 & Oct. 14, 1986) (permanent injunction entered); *Caprock-Plains Federal Land Bank Ass'n of Plainview* v. *Farm Credit Admin.*, No. CA-5-86-202, slip op. (N.D. Tex. Oct. 16, 1986 & Oct. 10, 1986) (preliminary injunction entered); *Colorado Springs Production Credit Ass'n* v. *Farm Credit Admin.*, No. 86-K-1948 (Sept. 26, 1986) (TRO entered) *with Northwest Louisiana Production Credit Ass'n* v. *Farm Credit Admin.*, No. 86-3164, slip op. (W.D. La. Oct. 16, 1986) (TRO denied); *Production Credit Ass'n of Eastern New Mexico* v. *United States*, No. 86-1137 JC, slip op. (D.N.M. Oct. 10, 1986) (preliminary injunction denied); *Central Kentucky Production Credit Ass'n* v. *United States*; No. 86-2056, slip op. (D.D.C. Oct. 3, 1986) (TRO vacated and preliminary injunction denied); *Great Plains Production Credit Ass'n* v. *Farm Credit Admin.*, No. 86-2119-A (Oct. 3, 1986) (preliminary injunction denied).

There are two key factors in determining fitness of an issue for judicial decision: whether the issue is "purely legal," *Abbott Laboratories*, 387 U.S. at 149, and whether the challenged action is a "final agency action" under the Administrative Procedure Act. *Id.* The defendants do not contest that the FCA's promulgation of the June regulations was a "final agency action" under the APA; their argument that the non-assessed plaintiffs' claims are not fit for judicial decision focuses on whether the issues presented are "purely legal."

The Court finds that the procedural validity of the June regulations is an issue fit for judicial decision as to all six plaintiffs. That five plaintiffs have not yet been assessed is immaterial to the legality of the FCA's waiver of notice and comment—a "purely legal" question. *Cf. Standard Oil Company* v. *Department of Energy*, 596 F.2d 1029, 1039 (Temp. Emer. Ct. App. 1978) (challenge to procedures followed by Federal Energy Administration in adopting regulations held "purely legal"). Also "purely legal" is the substantive issue presented to this Court, *i.e.*, the June regulations' consistency with the 1985 Amendments Act. *Cf. Caprock-Plains Federal Land Bank Association* v. *Farm Credit Administration*, No. 5–85–267, slip op. at 6 (N.D. Tex. March 11, 1986) (holding ripe substantive challenge to predecessor Farm Credit System fund transfer regulation, 12 C.F.R. § 611.1145 (1985), even though challengers had not been assessed).

In determining the hardship which would result to the parties by withholding judicial review, this Court must inquire whether "the impact of the regulations upon the [plaintiffs which have not been assessed] is sufficiently direct and immediate as to render the issue appropriate for judicial review at this stage." *Abbott Laboratories*, 387 U.S. at 152.

The June regulations have had sufficient impact upon all six plaintiffs to render judicial review appropriate at this time. As the FCA itself emphasizes, "the System's banks and associations function together as interdependent and financially interrelated cooperatives." Memorandum in Support of Federal Defendant's Cross-Motion for Partial Summary and in Opposition to Plaintiffs' Motion for Summary Judgment at 6. The September 1986 Capital Corporation assessment required purchase totaling $300 million has surely had a significant impact upon *all* Farm Credit System members—even those institutions which have not themselves been assessed.[7] Postponing judicial review for an indeterminate time would likely have an adverse effect upon the plaintiffs; on the other hand, adjudicating now all six plaintiffs' claims will have no foreseeable adverse impact upon the defendants.

Plaintiff Texas BC's claims are ripe. It would be pointless to adjudicate Texas BC's allegations that the regulations are invalid while denying the same adjudication to the other five plaintiffs. Such an approach would "fl[y] directly in the face of efficient judicial administration." *Independent Bankers Association of America* v. *Smith*, 534 F.2d 921, 928 (D.C. Cir.), *cert. denied*, 429 U.S. 862 (1976). It would frustrate both the principles set forth in *Abbott Laboratories* and common sense.

C. Procedural Invalidity

1. No Good Cause for Waiver of Notice and Comment Requirements.—Plaintiffs allege that in promulgating the June regulations, the FCA violated the Administrative Procedure Act's requirements of prior notice and an opportunity for comment. 5 U.S.C. § 553.[8] Defendants acknowledge non-compliance with the notice and com-

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[7] Indeed, the FCA's own financial analyst acknowledges that "[t]he Capital Corporation assessments will undoubtedly impact plaintiffs' financial position." Needham affidavit ¶ 62.

[8] The APA states, in relevant part:

> (b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—
>
> (1) a statement of time, place, and nature of public rule making proceedings;
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> (2) reference to the legal authority under which the rule is proposed; and
>
> (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved. . . .
>
> (c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant

Continued

ment requirements of section 553. They maintain that the June regulations were nevertheless promulgated in accordance with law. Defendants rely on section 553(b)(B), which authorizes an exception to the APA's notice and comment requirements, "when the agency for good cause finds (and incorporated the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." Thus, the procedural question before this Court is whether the FCA had "good cause" under section 553(b)(B) to waive the APA's notice and comment requirements.

Good cause for waiver of the APA's notice and comment requirement "is narrowly construed." *Levesque* v. *Block*, 723 F.2d 175, 184 (1st Cir. 1983); *Kollett* v. *Harris*, 619 F.2d 134, 145 (1st Cir. 1980).

> "Impracticable" means a situation in which the due and required execution of the agency functions would be unavoidably prevented by its undertaking public rule-making proceedings. "Unnecessary" means unnecessary so far as the public is concerned, as would be the case if a minor or merely technical amendment in which the public is not particularly interested were involved. "Public interest" supplements the terms "impracticable" or "unnecessary"; it requires that public rule-making procedures shall not prevent an agency from operating and that, on the other hand, lack of public interest in rule-making warrants an agency to dispense with public procedure.

S. Rep. No. 752, 79th Cong. 1st Sess. 14 (1945), *reprinted in* Senate Judiciary Committee, 79th Cong., 2d Sess., Administrative Procedure Act Legislative History 185, 200 (1946), *quoted in Kollett*, 619 F.2d at 145.

It cannot be said in this case that notice and comment were "unnecessary" or "contrary to the public interest," as these terms are defined. If there was good cause for the FCA's waiver of notice and comment, it was because these procedures were "impracticable."

Plaintiffs contend that the defendants have not met their burden of establishing good cause for waiver of notice and comment. Plaintiffs recognize, as they must, that the Farm Credit System is facing a severe financial crisis. But, plaintiffs note, although Congress imposed a specific deadline for chartering the Capital Corporation, Congress did *not* require that the compelled transfer regulations be promulgated by a date certain. The FCA had ample opportunity to provide prior notice and accept public comments during the nine months between the passage of the 1985 Amendments Act and the actual implementation of the June regulations. At the very least, the FCA could have complied with section 553 during the spring of 1986, when the FCA was making a series of computer analyses in preparation of the June regulations,[9] by simply publishing a "description of the subjects and issues involved."

Defendants argue that the Farm Credit System crisis fully justified the FCA's waiver of notice and comment. The June regulations were promulgated during and for this genuine national emergency. They were an essential prerequisite to the Capital Corporation's statutory mission—which Congress said should be implemented "as soon as practicable." The FCA chartered the Capital Corporation within its sixty-day deadline, and immediately thereafter issued regulations governing the Capital Corporation's organization and operation. The FCA then began developing the June regulations by conducting a series of computer analyses; it concurrently developed and implemented additional sets of regulations required by the 1985 Amendments Act. Given the critical and the complex tasks facing the FCA and the Capital Corporation, defendants maintain that it was impracticable for the FCA to comply with section 553's procedural requirements.

The Court finds plaintiffs' argument more persuasive than defendants'. The FCA's due and required implementation of the 1985 Amendment Act would *not* have been unavoidably prevented had it provided prior notice and opportunity for comment. In passing the 1985 Amendments Act in December 1985, Congress did nothing to suggest that the FCA should waive notice and comment. Even had Congress set a specific deadline for the promulgation of the compelled transfer regulations—as it did

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> matter presented, the agency shall incorporate in the rules adopted a concise statement of their basis and purpose. . . .

5 U.S.C. § 553.

"[T]he purpose of prior notice and comment is to afford persons an opportunity to influence agency action in the formative stage, before implementation, when the agency is more likely to be receptive to argument." *Kollett* v. *Harris*, 619 F.2d 134, 145 (1st Cir. 1980).

[9] These computer analyses are contained in the Administrative Record.

for chartering the Capital Corporation[10]—short statutory time constraints are not talismanic. *See Levesque* v. *Block, supra,* 723 F.2d at 180; *Kollett* v. *Harris, supra,* 619 F.2d at 145. The FCA could have and should have complied with APA § 553 in the spring of 1986.

Many of the cases upon which defendants rely involve agencies confronted with emergencies to which *immediate* response was necessary. Courts have found good cause for waiver of notice and comment in such circumstances where agencies promulgated *interim* or temporary rules. For example, in *American Federation of Government Employees, AFL-CIO* v. *Block,* 655 F.2d 1153 (D.C. Cir. 1981), the Department of Agriculture had two weeks to respond to a court order. The circuit court held that although there was good cause for waiver of notice and comment in promulgating the agency's temporary regulations, the same was not true for the agency's *permanent* regulations. The court stated:

> Common sense suggests that any administrative action taken in a rare "emergency situation . . . while perhaps necessarily 'immediately effective,' need only be temporary, pending public notice-and-comment procedures." *Valiant Steel and Equipment, Inc.* v. *Goldschmidt,* 499 F. Supp. 410, 412–13 (D.D.C. 1980). Here, however, we hold only that detailed regulations which respond—as these do—to much more than the exigencies of the moment must be promulgated through public procedures before they are chiseled into bureaucratic stone. Although in this case much study had apparently been done prior to the publications of the regulations, such pre- * * *. Therefore, once an emergency situation has been eased by the promulgation of interim rules, it is crucial that the comprehensive permanent regulations which follow emerge as a result of the congressionally-mandated policy of affording public participation that is embodied in section 553.

655 F.2d at 1157–58 (footnotes omitted). *See also Petry* v. *Block,* 737 F.2d 1193, 1200–03 (D.C. Cir. 1984) (combination of several extraordinary factors, including extremely limited statutory deadlines for promulgation of regulations and paucity of agency personnel, provided good cause for waiver of notice and comment in promulgation of interim rules); *American Transfer & Storage Co.* v. *Interstate Commerce Commission,* 719 F.2d 1283, 1293–94 (5th Cir. 1983) (current backlog and future flood tide of cases supported promulgation of interim regulations without notice and comment; public input had been invited before final regulations were issued); *National Federation of Federal Employees* v. *Devine,* 671 F.2d 607, 610–12 (D.C. Cir. 1982) (emergency constituted good cause for waiver of notice and comment in promulgating interim rules, where events and circumstances beyond agency's control were not foreseen in time to comply with notice and comment procedures).

In this case, of course, the challenged regulations are not interim, but final.

The Court holds that the FCA did not have "good cause" for waiving the APA's requirements of prior notice and opportunity for comment. The June regulations are procedurally invalid.

2. Remedy.—Defendants request that this Court nevertheless allow the regulations to stand as valid "interim" rules, pending repromulgation in accordance with the APA. An injunction against enforcement of the June regulations, defendants maintain, would be contrary to the public interest.

Interim rules have been allowed to stand, despite procedural deficiencies, principally to preserve the status quo or to prevent injury to those challenging the regulations until the agency can issue procedurally valid permanent regulations. *See American Federation of Government Employees, AFL-CIO* v. *Block, supra,* 655 F.2d at 1157 (emergency interim regulations allowed to stand so that federal poultry inspections could continue); *Western Oil & Gas Association* v. *Environmental Protection Agency,* 633 F.2d 803, 812–13 (9th Cir. 1980) (court desires to minimize intervention in complex environmental regulation); *Rodway* v. *Department of Agriculture,* 514 F.2d 809, 817–18 (D.C. Cir. 1975) (critical importance of regulations to continued functioning of food stamp program); *Valiant Steel & Equipment, Inc.* v. *Goldschmidt,* 499 F. Supp. 410, 414 (D.D.C. 1980) (two-year old emergency regulations allowed to stand for additional thirty days to ensure functioning of federal highway program; court notes that plaintiff waited over eighteen months before filing suit). But the case *sub judice,* allowing the June regulations to remain in effect as interim rules would neither preserve the status quo nor protect plaintiffs. The Capital Corporation would be free to *alter* the status quo to plaintiffs' detriment, by enforcing the assessment already made against plaintiff Texas Bank for Cooperatives, and by exacting additional compelled transfers against Texas BC and the other five plaintiffs.

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[10] In section 403 of the 1985 Amendments Act, Congress expressed not only its sense that the needs of the Farm Credit System and American agriculture required that the Act be implemented "as soon as practicable," but also its sense that "the President should ensure that the members of the Farm Credit Administration Board . . . are appointed not later than thirty days after enactment of this Act." Congress knows how to set specific deadlines when it so desires.

On the other hand, the Court must carefully consider the possible impact that immediately enjoining the June regulations might have upon the Farm Credit System, and, by extension, upon American agriculture. At the December 30, 1986 oral argument, the Court inquired counsel about this possibility. Counsel for the FCA replied that a ruling for plaintiffs could seriously deepen the financial crisis in the Farm Credit System. *See* Transcripts at 33–34. But counsel for plaintiffs asserted that Congress' recent authorization of modification of the System's accounting practices, allowing deferment of losses for up to twenty years, "will have the effect . . . of at least postponing the evil day." *Id.* at 56.

The Capital Corporation subsequently filed an affidavit of Richard T. Needham, its Vice-President and Controller. Needham explains in this affidavit that the new accounting methods will not be "a panacea for the System's difficulties." Needham Affidavit ¶ 8. To the contrary, Needham states, the new accounting will actually "compound the difficulties failing System institutions will face in January, February and March of 1987." *Id.* ¶ 7. More importantly, Needham estimates that the uncommitted resources currently held by the Capital Corporation with which it can assist troubled System institutions "will not be sufficient to satisfy the financial assistance needs of System institutions through the first quarter of 1987." *Id.* ¶ 9.

The Court takes Needham's affidavit very seriously. Were the June regulations only procedurally invalid, the Court would allow the regulations to stand as interim rules, pending re-promulgation in conformity with the APA. But because the Court also holds that the regulations are substantively invalid, subpart D, *post*, the Court cannot permit the regulations to stand even as interim rules.

D. Substantive Invalidity

1. Standard of Review.—In order to be substantively valid, a regulation must be consistent with the statute under which it has been promulgated. *E.g., United States* v. *Larionoff,* 431 U.S. 864, 873 (1977). Defendants urge the Court, in reviewing the June regulations' consistency with the 1985 Amendments Act, to give substantial deference to the FCA's interpretation of the Act. But deference to an agency's interpretation of a statute which it is charged with implementing is not permissible if Congress has spoken directly to the precise point in issue. *Japan Whaling Association* v. *American Cetacean Society,* 478 U.S. ——, ——, 92 L.Ed. 2d 166, 180 (1986); *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.,* 467 U.S. 837, 842 (1984). *See also St. Luke's Hospital* v. *Secretary of Health and Human Services,* No. 86-1602, slip op. at 17 (1st Cir. Feb. 3, 1987) (deference to agency's interpretation of statute inappropriate where statute is unambiguous).[11]

Here, Congress could hardly have spoken more directly to the point: Section 4.28G(a)(15) of the Farm Credit Act, as amended by the 1985 Amendments Act, clearly and unambiguously prescribes the criteria which the FCA's compelled transfer regulations must include; section 4.28J(a) plainly sets out the four prerequisites to discretionary federal aid. Thus, the FCA's interpretation of the statute is entitled to no special deference.

2. Plaintiffs' Substantive Claims.—Plaintiffs mount a multi-prong substantive attack on the June regulations. First, plaintiffs assert that the regulations' three "deeming" presumptions nullify their *pro forma* recital of the statutory criteria. Second, plaintiffs contend that the regulations compound this nullification by providing that nothing . . . shall prevent the Corporation from assessing or requiring an institution to purchase obligations when it has available capital and reserves." Section 611.1142(h)(6). Third, plaintiffs argue that the regulations fail to comply with the statutory command to include criteria taking into account "the effect on lending rates of financial assistance already provided to other System institutions." Section 4.28G(15)(B)(i)(III). We turn now to each of these three claims.

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[11] When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative determination. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

Chevron, supra, 467 U.S. at 842–43 (footnotes omitted).

(a) Section 4.28G(a)(15)(B)(ii)(I) of the Farm Credit Act, as amended by the 1985 Amendments Act, requires included in the FCA's compelled transfer regulations criteria which "ensure" that "the capital strength, earning capacity, loanable funds and overall financial viability of each System institution providing funds to the Capital Corporation are maintained at such a level that credit shall continue to be available to eligible borrowers on reasonable and competitive terms." The June regulations "deem" that "[a]ny assessment or required purchase" will have "no impact" on credit terms, whenever a transferor institution "has a positive level of adjusted loanable funds." Section 611.1142(h)(6)(ii). The FCA defines "loanable funds as interest-accruing assets less interest-bearing obligations. Section 611.1142(h)(1)(vi). "Adjusted loanable funds" is defined as "loanable funds adjusted by an amount representing the proceeds which the institution could receive from sale of all loans and acquired property eligible to be sold to the Corporation." Section 611.1142(h)(1)(i).[12]

Section 4.28G(a)(15)(B)(ii)(II) and (III) of the statute require included in the regulations criteria which "ensure" that each transferor institution "shall continue to have access to funds in the public financial markets," and be "able to maintain adequate financial reserves to satisfy its liability on its own obligations and on that portion of systemwide . . . obligations for which it is primarily liable." Under the June regulations, "[a]ny assessment and required purchase" is "deemed" to have "no impact" on an institution's access to funds and ability to satisfy its liabilities, "if the institution is able to satisfy the collateral requirements of section 4.3 of the Act [12 U.S.C. § 2154]." Section 611.1142(h)(6)(iii).

Finally, in section 4.228G(a)(15)(B)(i)(II), Congress mandated the inclusion of criteria which take into account "the effect, including the effect on loan interest rates, on current borrowers and members of each System institution." Once again, the June regulations "deem" that "[a]ny assessments and purchases" will have "no effect" on the lending rates of all Zones A and B institutions and of those Zone C institutions which charge interest rates below the average rate charged by all Zone C institutions. Section 611.1142(h)(6)(i).

Defendants maintain that these three "deeming" presumptions rationally implement the statute, construed in light of the critical situation facing the Farm Credit System and the resulting need for prompt, decisive remedial action. Moreover, defendants explain, the actual operation of the presumptions depends in each specific case upon the prior placement of each individual transferor institution according to the FCA's zone classification. This classification, in turn, is determined by an institution's particular financial circumstances. The combination of the individual zone classifications and the prerequisites for the application of the presumptions ensures, defendants argue, that both the financial strength of each transferor and the impact of an assessment and required purchase are accurately measured in compliance with the statute.

Each of the three "deeming" presumptions—standing alone—might be acceptable, although plaintiffs' challenges to each individual are strong. But the Court must construe the regulations in its entirety. So construed, the June regulations "deem" away almost all of the statutory criteria for assessments and purchase made *in any amount*. The zone classification may determine the *order* in which institutions are assessed,[13] but does not limit or condition the *magnitude* of such assessments.

The Court appreciates the urgency of the Farm Credit System's fiscal crisis, and recognizes that Congress required that strong institutions must make sacrifices to help save the weak. But Congress also directed the FCA to develop specific, detailed criteria to prevent the "self-help" mechanism from destroying the financial viability of healthy institutions. The June regulations' three "deeming" presumptions, taken together, to not comply with this direction.

(b) Any doubt about the substantive invalidity of the June regulations dissovles upon addressing plantiffs' next claim. Section 611.1142(h)(6) of the June regulations states, that as necessary to fulfill its mission, the Capital Corporation "shall assess or require System institutions to purchase obligations to the full extent of their available capital and reserves." [14] In so doing, the "Corporation shall take into consideration the criteria contained in paragraph (h)(6)(i) through (iii) of this section." *Id.* But, the regulations further provide, "*nothing* contained in this paragraph shall prevent the Corporation from assessing or requiring an institution to purchase obligations when it has available capital and reserves." *Id.* (emphasis supplied). Thus, the regulations expressly allow the Capital Corporation to take *all* of an institution's "available capital and reserves" *in complete disregard* of the statutory criteria purported incorporated into the regulations. This, plantiffs maintain, is plainly lawless.

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[12] The regulations further state, "These adjustments shall be equal to 80 percent of the book value of loans and acquired property eligible for sale to the Corporation, provided that such amount shall not exceed the amount that would cause the institution's unallocated retaining earnings percentage to fall below the level required for classification as a Zone C institution if the institution sold eligible loans and acquired property to the Corporation."
Id.

[13] Due to the zone classification, the June regulations take into account "the *relative* financial strength and ability to pay of the contributing institutions." Section 4.28G(a)(15)(B)(i)(I) (emphasis supplied).

In defense of its regulation, the FCA argues that the 1985 Amendments Act itself is internally contradictory, and that the June regulations properly resolve the statute's contradiction.[15] Specifically, the FCA contends that section 4.28J(a)(2), which requires FCA certification that the Farm Credit System must have "committed its available capital surplus and reserves to address" its financial crisis before discretionary federal aid is available, conflicts with the required criteria set forth in section 4.28G(a)(15)(B). The June regulations resolve this contradiction, the FCA explains, by providing a two-step assessment process. First, the Capital Corporation may only assess institutions which are classified in Zone A, B or C. These assessments must comply with the regulatory limitations on positive adjusted loanable funds, interest rate determinations, and collateral requirements. But, once all System instititutions have fallen to the bottom of Zone C or into Zone D, to qualify for federal aid the Capital Corporation must assess *all* of the System's remaining "available capital and reserves." To do this, the Capital Corporation must be free from the protections afforded to transferor institutions in section 411.1142(h)(6)(i), (ii), and (iii).

The FCA's premise that the statute is internally contradictory results from a rather selective myopia. The statutory prerequisites to discretional federal aid must be read together. In particular, section 4.28J(a)(2), the prerequisite which supposedly contradicts the requirement that the regulations implement specified protective criteria, must be reconciled with section 4.28J(a)(4). Therein, the Congress states that federal aid is predicated upon FCA certification that "the System has used such capital surplus and reserves *to the extent that further contributions from, or losses incurred by, System institutions likely will preclude such institutions from making credit available to eligible borrowers on reasonable terms.*" (Emphasis supplied).

Moreover, both sections 4.28J(a)(2) and (4) must be read in light of section 4.28G(a)(15)(A). Congress provides therein that the FCA's compelled transfer regulations must "include standards to ensure that, *consistent with sound business practices and subject to the criteria established under subparagraph (B) of this paragraph,* the available capital and reserves of System institutions are committed to providing financial assistance. . . . (Emphasis supplied.)

Reading the statute as a whole, and considering the clearly expressed Congressional intent that viable Farm Credit System institutions not be ruined by the Capital Corporation's assessments, the Court holds that the statutory "commitment" prerequisite to federal aid is satisfied when compelled transfers *reach* the "reasonable and competitive" credit term limit, *i.e.,* when available credit and reserves have been "used" to that extent. *The Capital Corporation may not assess beyond this point.* Congress did not authorize the Capital Corporation to overrule the "reasonable and competitive" credit term criterion, or any of the other required criteria. By permitting this, the June regulations directly contradict the Act.

The Report of the House Agricultural Committee corroborates this holding. In its introduction to the Farm Credit System "self-help" scheme, the Report states that the Capital Corporation's levies may not "reach a point at which the financial viability of local institutions would be imperiled, or at which local institutions would be left unable to make credit available to borrowers on reasonable and competitive terms." H.R. Rep. No. 425, *supra* at 2, *reprinted in* 1985 U.S. Code Cong. & Admin. News at 2588. In outlining how the bill's "mechanism for discretionary backstop aid from the federal government" would operate, the first requirement noted in the Report is FCA certification "that the System needs financial assistance and has committed its own available capital surplus and reserves to the point where a further drain on System resources would probably leave its institutions unable to serve their borrowers on reasonable terms." *Id.* at 4, *reprinted at* 2590-91.

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[14] As stated earlier, the regulations define "available capital and reserves" to exclude capital stock, participation certificates, allocated equities, and loan loss reserves.

[15] The Capital Corporation does not adopt the FCA's theory that the statute is self-contradictory. The Court takes this opportunity to note that the Capital Corporation's assertion that the statute requires mere non-binding "guidelines" is completely without merit.

(c) Finally, Congress also required included in the FCA's compelled transfer regulations criteria taking into account "the effect on lending rates of financial assistance already provided to other System institutions." Section 4.28G(a)(15)(B)(i)(III). Plaintiffs allege that the June regulations ignore this command.

The regulations do not explicitly include criteria accounting for the effect of prior assistance on transferors' loan rates. But, the FCA argues, the zone classification scheme implicitly incorporates such criteria. Each institution's zone classification is determined by its unallocated retained earnings percentage, which is a function of the institution's amount of unallocated retained earnings. An institution's unallocated retained earnings will be less if it has made prior financial contributions.

The FCA's argument is unpersuasive. Zone classifications are determined solely upon the percentage relation between an institution's unallocated retained earnings and its total assets. The FCA has failed to persuasively explain how an institution's unallocated retained earnings percentage has any particular relation to the magnitude of its prior voluntary assistance, its loan interest rates, and the effect its prior assistance has had upon its loan rates. All that the FCA demonstrates is that an institution that has made voluntary contributions will have less unallocated retained earnings than it would otherwise.

IV. CONCLUSION

There is no genuine issue as to any material fact. The claims of all six plaintiffs are ripe. The June regulations were promulgated in violation of the notice and comment requirements of the Administrative Procedure Act. The June regulations conflict with the 1985 Amendments Act.

The June regulations are procedurally and substantively invalid and are therefore void.

An appropriate Order shall issue.

FRANK H. FREEDMAN,
Chief United States District Judge.

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February 20, 1987

NOTICE TO ATTORNEYS FOR PLAINTIFFS
AND AMICI IN FARM CREDIT CASES

Re: Order Entered in Federal Land Bank of Springfield v. Farm Credit Administration

Late yesterday, we learned that Judge Freedman has modified his order entered on February 17th to limit the scope of the injunctive relief to the plaintiffs in our case. Judge Freedman's action came in response to a government motion to modify or clarify the order filed yesterday morning -- because he acted so quickly, we had no opportunity to oppose the motion.

The modifications in the order are as follows:

- page 2, line 3 - Insert "as regards plaintiffs" following "action".

- page 2, lines 4 and 6 - Replace "System institutions" with "plaintiffs".

Richard G. Slattery

Richard G. Slattery

STATEMENT OF FRANK W. NAYLOR, CHAIRMAN FARM CREDIT ADMINISTRATION BOARD

It is an honor for me to appear before this distinguished subcommittee of the Agriculture Committee to give you an update of our status as a newly created federal financial regulator.

1985 FARM CREDIT AMENDMENTS ACT

The Farm Credit Amendments Act of 1985, as you know, made the Farm Credit Administration (FCA) an arm's length Federal regulator of the financial institutions of the Farm Credit System (System), a privately owned and operated financial cooperative. The three member FCA Board comprised of Marvin R. Duncan, Jim R. Billington, and myself, was appointed by the President, and given the responsibility and authority by Congress to regulate, examine and certify the condition of the System to Congress and the Executive Branch. Mr. Duncan and myself were confirmed by the Senate in May of 1986 and Mr. Billington in October.

FCA has similar authorities as other Federal regulators of financial institutions including the power to issue cease and desist orders, to levy civil money penalties, and to remove officers and directors of system institutions.

The FCA's principal objective is to assure the safety and soundness of the System institutions and to protect the interests of borrower/stockholders, investors, and the public. The agency does not nor is it authorized to participate in the routine management or operations of System institutions. FCA involves itself in management and operations of System institutions only when the Farm Credit Act or its regulations have been violated, when taking an action to correct an unsafe or unsound practice, or when assuming a formal conservatorship over an institution.

More than 40 institutions of the System have been examined under the reorganized FCA. To date the FCA has initiated 25 enforcement actions including 15 cease and desist orders, 8 formal written agreements and two supervisory letters.

With the 1985 Farm Credit Act Amendments Congress also created the Farm Credit System Capital Corporation. This System institution is responsible for working with System institutions on restructuring or administering nonperforming assets, and carrying out a program of financial assistance among institutions of the Farm Credit System.

In 1986 $1.183 billion was identified for transfer among System institutions through Capital Corporation assessments, System Capital Preservation Agreements, or other loss sharing agreements. Some 20 lawsuits have been filed challenging the transfering processes.

1986 FARM CREDIT ACT AMENDMENTS

In 1986 the Farm Credit System proposed Regulatory Accounting Practices (RAP) legislation to allow institutions to amortize over 20 years certain specified expenses, in effect giving themselves a 20 year loan.

The Farm Credit Amendments Act of 1986 was accepted in the closing hours of the 99th Congress as an amendment to Omnibus Reconciliation Act. In addition to the RAP provisions, it removed the Farm Credit Administration from prior approval of System interest rates.

The practical consequence of the RAP legislation is to provide time for System institutions to work on their operating difficulties. The FCA regulations require System institutions to provide their stockholders, and investors in their bonds, financial statements which clearly disclose their financial condition under Generally Accepted Accounting Principles (GAAP) with the effect of RAP disclosed in footnotes. We believe this was the intent of Congress in the 1986 Amendments.

There is no magic in regulatory accounting. It brings no new resources to the System. Losses still have to be taken as they occur. Obligations have to be met when due. Additional time to develop solutions to problems is its principal attraction.

SYSTEM PROBLEMS - THE REGULATORY PERSPECTIVE

The System's problems from the regulator's perspective are four fold; nonearning assets, excessive administrative expenses, outstanding high priced debt and member relations.

The System has two kinds of nonearning assets -- acquired properties and nonaccrual loans.

The System has $1.110 billion in acquired properties and is carrying $7 billion in non-accrual loans. It also has another $5 billion in loans classified as high risk. Of 58,616 nonaccruing loans about 1,500 have been restructured, or about 3 percent of the nonaccruing loans. Acquired property is an equally difficult problem. Indiscriminate disposal of this volume in the currently depressed market would likely drive land prices even lower.

The System's cost of doing business is about $800 million annually and has remained constant for the last several years. The elimination of staff duplication, nonproductive offices and unnecessary labor on low yield loans could help reduce overhead.

The high-cost debt problem can't be solved immediately. Some of the System bonds do not mature until 2003 and because the securities have no call provisions the owners can hold them until maturity. Regulatory accounting may be a partial solution to this problem since a portion of the debt could be amortized over 20 years.

The fourth problem is what I have termed member relations. Any cooperative program is dependent on good member relations. Members loans need to be cultivated and nurtured. Borrowers need to be informed of the condition of their institution, and need to be educated about services and programs. At FCA we have attempted, by regulation, to guarantee certain rights to borrowers which were mandated in the 1985 Amendments. As a result, institutions are now required to inform borrowers of interest rates being charged at the time of the loan and any variation in that rate, or the effective rate, over time. Also borrowers have the right to copies of all the documents which they sign at the loan closing.

LEGISLATION - 1987

Given a reasonable amount of time there is no question that the System could adjust to the problems outlined. However, when combined with its current financial condition it is very likely that some form of adjusting legislation may be necessary during the upcoming year.

As you are aware, Mr. Chairman, the Government Accounting Office was instructed last year to prepare a package of options or proposals to improve the System. It is our understanding that these proposals will be delivered to Congress in late March or early April.

It is my opinion that as a federal financial regulator it would not be proper for the Farm Credit Administration to propose legislation. At the same time, in order to best serve Congress and the Administration, it is incumbent on the FCA to be aware and responsive to proposals that may be offered.

Currently we are aware of several serious legislative proposals being circulated for discussion. These range from consolidation of the Sytem into a centralized national lender, to decentralization into semi-independent institutions without joint and several liability.

Secondary market proposals are also attracting attention. These proposals presently include a System-operated secondary market program and an independent secondary market. It is our opinion that an independent secondary market, with separate agency status outside of the Farm Credit System, would spell the end of the

Federal Land Bank System.

Mr. Chairman this concludes my statement for the record. I have attached a brief appendix which details some of the Farm Credit Administration's activities since last May when I became Chairman of the Board and chief executive officer of the agency. As you know, Mr. Duncan was appointed a member of the Board at that same time, followed in October by our colleague Mr. Billington.

We would be happy to respond to your questions.

Appendix follows:

APPENDIX

FCA: THE REGULATOR OF THE FARM CREDIT SYSTEM AND ITS REVIEW OF THE FINANCIAL CONDITION OF THE SYSTEM

Role of FCA

- FCA is an independent financial examination and regulatory agency in the executive branch of the Federal Government.
- FCA examines and regulates Federal Land Banks and Federal Land Bank Associations, Federal Intermediate Credit Banks and Production Credit Associations, the Banks for Cooperatives and service organizations organized by System banks.
- The agency's objective is to assure the safety and soundness of System institutions and protect the interests of borrower-stockholders, investors, and the public.
- FCA has similar authorities as other Federal regulators of financial institutions including the power to issue cease and desist orders, to levy civil money penalties, and to remove officers and directors of System institutions.
- The agency does not nor is it authorized to participate in the routine management or operations of System institutions. The agency involves itself in management and operations of System institutions only when

  -- the Farm Credit Act or its regulations have been violated,
  -- taking an action to correct an unsafe or unsound practice,
  -- assuming a formal conservatorship over an institution.

FCA Accomplishments Since June 1986

Organization:

- Full three-member Board established
- Reorganized FCA in accordance with 1985 Farm Credit Act Amendments
- All senior staff and Division Head slots filled
- Increased examination staff from 182 to 355 permanent full-time employees (presently at 93 percent of full strength) to fulfill examination mandate under the 1985 Amendments.

Examination and Enforcement:

- o Examined over 40 institutions under guidelines of new Examination Manual. All except four supported administrative actions.

- o Enforcement actions authorized by FCA Board (25 total covering five Districts)
  - -- Cease and Desist Orders (11 PCAs; 3 FICBs, 1 FLB)
  - -- Written Agreements (5 PCAs; 2 BCs; 1 FICB)
  - -- Supervisory Letters (2 FCS service organizations)

- o Pending Enforcement Actions (14 total; covers 8 Districts)
  - -- Cease and Desist Orders (5 PCAs)
  - -- Written Agreements (2 PCAs, 1 BC)
  - -- Administrative hearings (previous consent C&D) (2 PCA;, 1 FICB; 1 FLB)
  - -- Supervisory Letters (1 FICB; 1 BC)

Regulations:

- o Final Regulations Implementing 1985 Amendments
  - -- Capital Corporation Assessments and Funding (effective June 13, 1986).
  - -- Rules of Practice and Procedure. Practice Before the FCA (effective July 28, 1986).
  - -- Shareholder Disclosure Regulation, Amendment to (effective July 29, 1986).
  - -- Mergers, Consolidations and Territorial Transfers (effective October 13, 1986).
  - -- Receiverships and Conservatorships (effective October 13, 1986).
  - -- Borrower Rights (effective October 28, 1986).
  - -- Technical Amendments to the FCA Regulations (effective November 20, 1986).
  - -- Disclosure to Shareholders; Accounting and Reporting Requirements, Amendments to (effective November 21, 1986).

- o Proposed Regulations Implementing 1985 Amendments
  - -- Capital Adequacy. Published in FR: July 23, 1986.
  - -- Organization; Director Compensation. Published in FR: December 9, 1986.
  - -- Funding and Fiscal Affairs; Investment Activities by System Banks. Published in FR: December 9, 1986.

- o Final Regulations Implementing 1986 Amendments
  - -- Temporary Regulations; Regulatory Accounting Practices (effective December 24, 1986).

-- Temporary Regulations; Regulatory Accounting Practices, Technical Amendments to (effective December 24, 1986).

Pending Litigation (Total of 50 lawsuits pending)

o 15 lawsuits have been filed by various FCS institutions challenging the FCS Capital Corporation statue and/or FCA assessment regulations and/or Capital Directive No. 1.

o 2 lawsuits filed challenging alleged impairment of OFI equities as a result of Capital Preservation Agreements and/or assessments by Capital Corporation.

o 2 lawsuits filed challenging FCA's RAP regulations which prohibit reversal of third quarter 1986 under the Capital Preservation Agreement.

o 2 lawsuits filed relating to borrower rights regulations.

o 19 foreclosure related lawsuits filed.

o 8 lawsuits on miscellaneous other issues filed.

Financial Condition of FCS

o Combined System Financial Results. The System continued to experience deterioration of credit quality of its loan portfolios, significant operating losses, and further reductions in total capital. Significant financial results, presented in accordance with generally accepted accounting principles for year ended December 31, 1986, included:

-- Net loans outstanding were $54.6 billion, compared to $66.6 billion at the end of 1985.

-- Nonaccrual loans increased to $7.07 billion, compared to $5.323 billion at the end of 1985. Other high risk loans which still accrue interest but have been identified as potential problem loans, approximated $5.7 billion, compared to approximately $4.0 billion at the end of 1985. Included in the other high risk category at December 31, 1986 are $1.0 billion of loans 90 days or more past due but which are well secured and in the process of collection.

-- Other property owned (acquired primarily through foreclosure actions) increased to $1.101 billion compared to $928 million at the end of 1985. Losses on other property owned in 1986 and 1985 were $233 million and $285 million, respectively.

-- Provision for loan losses and net chargeoffs for the year were $1.798 billion and $1.353 billion, respectively, compared to 1985 amounts of $2.969 billion and $1.105 billion, respectively. The allowance for loan losses increased to $3.635 billion (6.24 percent of loans outstanding), compared to $3.190 billion (4.5 percent of loans outstanding) at the end of 1985.

-- Net losses were $1.913 billion for 1986 compared to $2.689 billion in 1985.

-- Farm Credit securities outstanding decreased to $62.5 billion in 1986, compared to $68.9 billion in 1985.

-- Farm Credit System total capital (consisting of capital stock, participation certificates and surplus) amounted to $5.641 billion, a decrease of $2.729 billion from the 1985 yearend balance. Surplus declined to $1.453 billion from $3.401 billion at 1985 yearend.

Net interest income was adversely affected in 1986 as a result of increased nonearning assets and declines in loan volume. Net interest income will continue to be negatively impacted since a significant portion of the System's debt outstanding is comprised of higher cost, long-term obligations. Reduced loan demand, competitive pressures from other lenders and borrower concerns over the System's financial condition have been principal contributors to the declining loan volume.

o Federal Land Banks

The following are preliminary data as of February 10, 1987.

-- Net loans outstanding to farmers and ranchers were $38.4 billion, down $8.4 billion for the year, and included $5.8 billion of nonaccrual loans, up $1.8 billion. Net acquired property reached $910 million, from $722 million at the end of 1985. Loan chargeoffs during 1986 totaled $938 million, compared to $460 million in 1985.

-- Net losses for 1986 were generated primarily in the FLB System, totaling $1.71 billion on operations and $1.36 billion, after financial assistance. This represented a slight improvement over the $2.02 final net loss of 1985.

-- The net interest margin for the year was an inadequate 0.30 percent, but turned from a -0.21 percent in the third quarter to 0.24 in the fourth.

-- Capital and surplus at yearend dropped from $3.75 billion to $2.04 billion, with the surplus account turning negative on a GAAP basis.

- o Federal Intermediate Credit Banks

The following are preliminary data as of February 10, 1987.

-- The FICBs as a group produced a net income of $11.5 million in 1986, even after contributing to financial assistance and related items. All 12 FICBs produced net income from operations for the fourth quarter and for the year. However, after deductions for financial assistance and other nonoperating items, nine of the 12 had losses for the year. The income reflected an improvement from an $89 million loss in 1985.

-- Net loans and discounts outstanding to PCAs and other financial institutions stood at $10.83 billion on December 31, down $3.94 billion for the year. Nonaccrual loans dropped $26 million to $167 million at yearend, while acquired property grew only slightly, from $23 to $26 million.

-- During 1986, FICBs charged off $29.9 million, compared to $38.6 million in 1985.

-- Total capital and surplus stood at $1.83 billion at the end of 1986, compared to $1.87 billion in 1985.

- o Banks for Cooperatives

The following are preliminary data as of February 10, 1987.

-- The combined BCs generated net income for the year as well as the final quarter, after assessments for financial assistance. Combined net income for 1986 was only $0.2 billion, but income from operations was $72.1 million. Financial assistance was the primary component of charges totaling $77.4 million from the operating income.

-- Gross loans outstanding fell from $8.26 billion to $7.52 billion at yearend, but the nonaccrual component also decreased from $131 million to $48 million. Net acquired property grew slightly, from $11 million to $16 million.

-- Allowance for losses on loans increased to $146 million in 1986, compared to $132 million in 1985. BCs had a net recovery of $2 million in 1986, compared to chargeoffs of $13.8 million in 1985.

-- Total capital stood at $1.10 billion on December 31, down from $1.17 billion at the end of 1985, and the surplus component eased down from $333 million to $303 million over the year.

- Production Credit Associations Only

The following are preliminary data as of February 13, 1987.

-- Nearly three-fourths of the remaining earned net worth of the combined banks and PCAs is in the PCAs, where it is not fully accessible.

-- Net loans dropped 18.0 percent to $10.7 billion, while nonaccrual loans increased 7.9 percent to $1.02 billion.

-- The preliminary yearend 1986 nonaccrual loan volume is $1.017 billion compared to $943 million in 1985.

-- Acquired property held was $150 million at the end of 1986 vs. $184 million at the end of 1985.

-- Allowance for losses accounts decreased to $2.699 billion in 1986, compared to $3.08 billion in 1985.

-- Net losses were $290 million in 1986, compared to $677 million in 1985. Provision for losses was less than half the 1985 drain, $356 million vs. $773 million.

-- Total PCA capital dropped to $2.24 billion in 1986 vs. $2.83 in 1985. The surplus cushion for stockholders was $1.08 billion vs. $1.29 billion a year earlier and a peak of $1.99 billion at the end of 1983.

STATEMENT OF MARVIN R. DUNCAN, MEMBER
FARM CREDIT ADMINISTRATION BOARD

Mr. Chairman, since their enactment by the Congress, the Farm Credit Administration has put forth considerable effort to implement the Farm Credit Act Amendments of 1985 and 1986.

To accomplish that task, we have issued the following regulations.

* Farm Credit System Capital Corporation Assessments and Funding, effective June 13, 1986.

* Rules of Practice and Procedure. Practice Before the Farm Credit Administration, effective July 28, 1986.

* Amendment to Shareholder Disclosure Regulation, effective July 29, 1986.

* Mergers, Consolidations and Territorial Transfers, effective October 13, 1986.

* Receiverships and Conservatorships, effective October 13, 1986.

* Borrower Rights, effective October 28, 1986.

* Technical Amendments to the Farm Credit Administration Regulations, effective October 28, 1986.

* Amendments to Disclosure to Shareholders; Accounting and Reporting Requirements, effective November 21, 1986.

In addition, we have proposed regulations dealing with Capital Adequacy, Organization; Director Compensation, and Funding and Fiscal Affairs; Investment Activity by System Banks.

To comply with the congressional mandate that we conduct examinations of all Farm Credit System institutions, we have doubled our examination force to 382 examiners and now have ten field offices at strategic locations around the country. These new examiners go through an intensive two-month training program called "Constructive Agricultural Lending" and are taught all phases of conducting an association examination.

We have also developed a comprehensive examination manual that has been distributed to all examiners and Farm Credit System institutions.

To ensure that corrective actions are taken when the examination of an institution reveals that Federal law or regulations have been violated or when operational or management deficiencies that result in unsafe or unsound practices are uncovered, we have a Supervision Division within our Office of Analysis and Supervision. This division, in coordination with the Office of General Counsel, prepares our enforcement strategies.

To implement the 1986 amendments, we have removed ourselves from the approval of specific interest rates. We have, however, cautioned the Farm Credit System institutions that establishing overall rates that would render them unable to cover their cost of operations and unable to generate capital would be considered an unsafe and unsound practice and may require us to take corrective action.

We have also issued temporary regulations to implement the Regulatory Accounting Practices (RAP) provided for in the amendments. These regulations allow Farm Credit System institutions to defer and capitalize a portion of interest costs, provisions for loan losses, and premiums paid to retire debt instruments for up to 20 years.

Institutions that elect to use RAP are obligated to provide full disclosure to stockholders, loan applicants, and investors under Generally Accepted Accounting Principles. They must also notify borrowers and loan applicants of the effect of RAP on their equity and have a clear plan for retiring of borrower-owned stock.

Seven Federal Land Banks and one Production Credit Association had implemented RAP at December 31, 1986, to prevent stock impairment through the deferral of $393 million in provisions for losses. At this time, each of them has continued to retire member stock at par value.

The Farm Credit Administration, however, takes no position on whether institutions should adopt regulatory accounting. The decision to use it rests with the the institutions.

Nor do we view RAP as a means of solving the system's problems. It brings no new resources to the system. Losses must still be taken as they occur. Securities must still be collateralized and redeemed when due. At best, the use of regulatory accounting buys the system some time in which to seek more permanent solutions to its problems.

One of the most immediate of those problems is the collateral position of some system institutions.

The law and FCA regulations require each Farm Credit Bank to maintain collateral at least equal in value to the total amount of obligations for which it is primarily liable as a condition for participation in system wide issues.

As of September 30, 1986, each bank was in compliance with this collateral requirement, though it is our understanding that by December 31, 1986, one had to enter into a collateral sharing agreement with the other two banks in its district in order to meet the regulatory collateral requirements. However, other Federal Land Banks barely meet the requirement and may be deficient in 1987.

To deal with this problem, the system is considering an inter-district collateral sharing agreement under which banks having excess collateral would share a portion of their the excess with banks having collateral deficiencies.

Implementation of regulatory accounting will not prevent such deficiencies and could accelerate them if third quarter financial assistance from strong institutions to weaker ones is reversed.

Such assistance, in the form of the 37-Bank Capital Preservation Agreement, was triggered during the third quarter of 1986 by the Federal Land Banks of Omaha, Wichita, St. Paul, Louisville, Jackson, and St. Louis.

The Farm Credit System reported operating losses of $1.8 billion for the year ended December 31, 1986, and $2.7 billion for the previous year.

Against that backdrop, there are 23 law suits in which Farm Credit System institutions have sued the Farm Credit System Capital Corporation, the Farm Credit Administration, and, in some instances, each other in attempts to thwart the intent of the Farm Credit Act Amendments of 1985 and 1986.

With that, Mr. Chairman, I'd be happy to respond to any questions the committee may have.

STATEMENT OF JIM R. BILLINGTON, MEMBER FARM CREDIT ADMINISTRATION BOARD

Mr. Chairman and distinguished Members of the Senate Agriculture Subcommittee on Credit:

I appreciate the opportunity to appear at this hearing to discuss my concerns about the situation which exists in the Farm Credit System today.

As you no doubt know, the System is facing serious financial problems. I am sure you have heard much about these problems throughout the day. Currently, System entities are losing $1 billion in business each month. Twenty-five percent of the System's portfolio is in non-accrual loans or high risk assets, an increase of 10 percent since December 31, 1985. In addition, the System is continuing its deterioration both in the services it offers to borrowers and its ability to reduce overhead expenses. In many of the districts where Federal Land Banks are in serious trouble the local employees of Federal Land Bank Associations are afraid to venture forth in their communities due to the many foreclosures and loan servicing problems with which they must deal daily. There is an image problem which will take years for the System to overcome. The turnover in employees has been phenomenal. Many of the System's current employees are young, inexperienced persons who are insensitive to the economic and social havoc found in the rural areas in which they serve. It is difficult to comprehend the change in feelings among rural Americans for this institution that served farmers so well until land prices took a nose-dive.

Despite all its problems, the System remains in a gridlock due to lawsuits between System entities and the Capital Corporation and between System entities and the FCA. The 1985 and 1986 amendments, as Congress envisioned them, have enjoyed a very rocky and difficult implementation. The FCA is dealing with 52 lawsuits as of February 6, 1987. Barring resolution of these lawsuits, I see no possibility that the System can muddle through this year without some type of assistance. Our nation can ill afford the shutdown of this cooperative Farm Credit System due to the inability of System entities to cooperate with one another and resolve these problems, as was intended by Congress. We, at FCA, also have the responsibility to use our resources to help alleviate these problems, as long as the safety and soundness of the institutions are not affected.

If this System is to survive, many important and difficult decisions must be made in the near future. It seems that everyone has a solution. These solutions involve restructuring, asset and liability management, policy-making, and law and policy to regulate the System. Discussions include every possible scenario, from more centralization of decision-making, to less centralization, and every possibility in between. I must admit that I am still searching for what I feel is the appropriate answer to any System restructuring plan. It is an issue I am continually studying. While I have not yet settled on what I feel would be the best way to restructure and streamline the System, I will say that there is one basic status which must be retained--the Farm Credit System's cooperative nature.

There are many persons today who feel this cooperative status should no longer be maintained. If it is removed, and I sincerely hope that it will not be, Congress had better be prepared to go back within a short time and re-legislate a new credit system, on a cooperative basis, because the farmers and ranchers in rural America will demand it.

My opinion is that we should look at the 1971 Act, as amended, and work toward improving this legislation. The 1971 Act allowed the Federal Land Banks to change their appraisal standards and to make loans based on 85 per-cent of the appraised value of the land, and not on productive capacity. The Act also authorized variable interest rates on Federal Land Bank loans which took the pressure off management to match securities with their loans. This, in my opinion, may have been a serious mistake. The legislation also permitted the Federal Land Banks to delegate authority to the FLBAs to make loan commitments, do appraisals, and close loans. This authority has been abused.

The law also addressed many other issues such as loss-sharing plans, Consolidated, System-Wide Bonds, and joint and several liabilities. It allowed FCA the authority to delegate many of its powers to the District Banks. Of particular note was the authority for the Banks to examine their own Associations. This was a mistake, and has been corrected by the 1985 Amendments to the Act. Many of the powers of local Associations that existed prior to this Act were lost due to the District Banks' authority to approve all the policies of the local Associations.

If we look at the System's track record, it is clear that most of the unallocated surplus in the System is in the locally-managed Production Credit Associations. Of the $1,362,000,000 in unallocated surplus in the System, the PCAs controlled $1,081,000,000, approximately 80 per cent, as of December 31, 1986. If all this capital is assessed, according to FCA regulations, the PCAs will have to charge their farmer-borrowers an additional $120 million annually in interest to cover the loss of this capital. This is the primary reason behind many of the lawsuits which are hamstringing the System.

By and large the huge losses suffered by District Federal Land Banks are shifting. At the end of last year, all 12 Banks were suffering losses, according to the FCA's preliminary FLBA report of operations for 1986. The highest net earnings losses were suffered by St. Paul, $318,710,000, followed very closely by Columbia, $292,002,000. Other Banks and their 1986 net earnings losses included: Springfield, $27,420,000; Baltimore, $68,397,000; Louisville, $56,850,000; Jackson, $96,373,000; St. Louis, $88,062,000; Omaha, $39,437,000; Wichita, $11,701,000; Texas, $88,543,000; 5 Sacramento, $114,724,000, and Spokane, $157,568,000. Some banks' losses have increased dramatically where least expected.

The Bank for Cooperatives and the Central Bank for Cooperatives seem to be on track, although they continue to experience small losses in volume. The Bank for Cooperatives needs to maintain a credit system that can serve cooperatives of any size, so long as the loans are sound and have a necessary purpose.

In addition, the PCA and FLBA Systems are replete with duplicity, suffering from over-review and examination. Recently, I visited a California FLBA which, I was told, had been examined by the FCA, the Sacramento FLB, Price-Waterhouse, and the Capital Corporation all within a short time period. I was informed that other associations have experienced these same reviews, plus scrutiny from the General Accounting Office. Associations are also being besieged with requests for information from the FCA, District Banks, the Capital Corporation, the Farm Credit Corporation of America, and in some cases, the Funding Corporation and the Farm Credit Council. This is a time of great change and a period in which the System is suffering serious problems, but we cannot paper shuffle or examine or review our way out of the problems we are facing! More importantly, many well-managed Associations do not need these multiple reviews and their borrower/stockholders certainly cannot afford what is now being required. This costly paperwork also detracts the employees from the more serious and pressing need to help distressed borrowers, acquire much-needed new 6 business, and service existing borrowers. The FCA is trying to eliminate much of this unnecessary paperwork and red tape by enacting new regulations and encouraging banks to reduce their examination and supervision staffs. Unfortunately, to do so takes time. Our full Board was finally put into place only in October, just four months ago, so we are essentially a new agency trying to get our arms wrapped around a huge set of problems.

The Farm Credit System may need to bring local directors and stockholders back into some of the decision-making process, consulting them about how to address loan restructuring, how to acquire new business, and how they might aid management in living within reasonable operating expenses, as the System did when it first began. Somehow we must figure out a way to stem the loss in volume. Reducing overhead expenses may be a partial solution. Overhead costs in many districts and associations are entirely too high and must be brought into line with income. In addition, Association mergers on a district-wide basis have materially hampered local decision-making, director input, and services to members. Associations are also finding themselves buried in many ill-founded, unneeded policies and rules which tie their hands in loaning and collecting money. Some paperwork and loan servicing requirements are unbelievably complex.

While immense, these problems are certainly not insurmountable. What must be done? First, it is time to take action to convince the stockholder that he is not going to lose money on his stock. We, at FCA, must also convince our employees of the need for a very valiant effort to reduce duplication and waste in the System. The FCA as an agency must continually analyze and probe to see if it can be more responsive to System problems and, if possible, explore ways to assure that stockholders' and investors' interests are protected.

The System is trying to face the primary issues. It is trying to stop the tremendous loss in volume. It is moving to restructure the non-accrual loans. It is attempting to liquidate acquired property. It is addressing the issue of servicing troubled borrowers. Loan servicing is receiving attention. The System is now beginning to realize again that its primary goal is to provide the farmers and ranchers of this country, and their cooperatives, with a reliable and dependable source of credit.

The Farm Credit System, as a whole, has only one basic purpose and that is to disintermediate low cost funds from the money center in New York City to the farmers and ranchers of rural America. This must be done at a cost that is affordable and dependable, based upon the financial needs of today's farmers and ranchers. These things must all be done, while somehow hoping that commodity prices improve, interest rates go down, and land values stabilize.

The System itself must realize that the glory of yesterday has passed and that the income is going, the goodwill has been bruised, and that the quality of loans is continuing to rapidly. FCA must be given time to reach its appropriate status as a competent, arms-length regulator of System entities. If we can accomplish these goals, then I think the System, with financial help from the government in some form, and where absolutely needed, can survive.

Thank you very much for this opportunity. I would be happy to entertain any questions the Committee might have.

Prepared Statement of Larry D. Buegler, president and chief executive officer, Farm Credit Services of St. Paul, St. Paul, MN

Mr. Chairman and members of the Subcommittee:

I am pleased to be here today to review with you the conditions in the Seventh Farm Credit District, which includes Minnesota, North Dakota, Wisconsin and Michigan.

The Seventh District is the largest district in the System with $10.6 billion in assets as of December 31, 1986 and provides services to more than 100,000 farmers, ranchers and cooperatives.

I joined Farm Credit Services in September 1986 after spending 27 years with Norwest Corporation, a multistate bank holding company headquartered in Minneapolis, Minnesota. My responsibilities at Norwest over the years included farm management, estate planning for farmers, commercial lending to agriculture to producers and agribusinesses and in recent years I was chairman of the board and chief executive officer of six Norwest banks.

As an agricultural economics graduate from the University of Minnesota and a banker, I have been very familiar with Farm Credit and for years had competed with the System for agricultural loans, participated with Farm Credit in large lending transactions and negotiated back-up lines-of-credit for two Farm Credit districts.

Over the years, I had admired the System which competed very effectively with banks and had hired their employees who were well trained and experienced in ag lending. Therefore, when I received a telephone call from an executive search firm looking for candidates for the St. Paul District CEO position, I knew what the issues and problems were in agriculture and Farm Credit.

After two months of talking with the Seventh District Board of Directors and researching a number of issues, I decided to take the position. After five months on the job, my only regret is that I didn't take the job sooner.

The situation in the Seventh District at the end of September 1986 was a total loan portfolio of $9.4 billion; $1.5 billion of nonaccrual loans and $222 million of acquired property. Because of declining land values, we made an additional $194 million provision for loan losses in the third quarter, and for the nine months of 1986, net operating losses were $283 million. This caused the District for the first time to seek assistance of $179 million from other districts to stop capital impairment in the Federal Land Bank (after having provided approximately $160 million of financial assistance to other districts in 1985 and 1986).

Our projections at that time indicated the District would have additional losses in the fourth quarter, and in 1987 would be faced with its first cash loss ever--that is a loss before the provision for loan losses.

This expected loss was based upon a projection that our loan volume would go down dramatically, nonaccruals and acquired property would increase and that expenses would remain flat.

It was clear that something had to be done to reverse those trends. It was also clear that time was running out. We had to do something bold--quick! For the first few weeks, I traveled across the District gathering ideas on what could be done, and asking questions such as how many of those loans on nonaccrual did we have with a good producer, with good financial records and the only mistake he ever made was to be born at the wrong time and had to pay too much for his land and if both the lender and the borrower made compromises, could we get that loan back to accrual? I was told that 50 percent of the nonaccrual loans could be restructured to viability.

Raising questions about acquired properties, I was told that if we got creative in our financing of land sales, we could sell 50 percent of our land at or above appraised value. We revised our forecast for 1987 based upon a 50 percent reduction in nonaccruals and acquired property. The new forecast said if we reduced expenses 10 percent, we could break even before loan loss provision rather than be faced with an $86 million cash loss.

That, then became Phase I of our recovery plan which was approved by our more than 350 local association service center farmer-directors in late November. In December, we began communicating that plan to each and every one of our 2500 employees and prepared them for implementation.

In January, we started our acquired property sales blitz in Wisconsin, advertising nationwide "Buy Wisconsin" for as little as 4.9% interest. We set up hot lines to handle the calls but seriously underestimated the amount of interest that would be generated in farm land. Because of the interest in Wisconsin, we moved the program to the other three states on February 1. In the first six weeks, we received over 20,000 inquiries on our 2,000 parcels of land held for sale. Year-to-date, we have sold 176,437 acres out of our beginning January 1 inventory of 580,000 acres.

The amazing thing is that almost 90% of the land is being sold to farmers at an average of 105 percent of appraised value, with the majority of that selling for cash or at an interest rate of 8.9 percent.

In January, we moved special credit teams into our service centers to evaluate the non accrual portfolios loan-by-loan. A bottom-line settlement was established for each of our 6,000 nonaccrual loans in the Land Bank and 2,100 loans in the Production Credit Associations. Approximately four weeks ago, we started our restructure program and as of last Friday, had reached agreement and signed letters of understanding with 2,350 Land Bank borrowers and 650 Production Credit Association borrowers to restructure their debt.

On a percentage of loan volume basis, we have negotiated 37 percent of our nonaccruals. Again, we were surprised by the interest our borrowers have in this part of our recovery plan and now, rather than additional losses on non accruals, we will likely experience recoveries over established allowances and previous chargeoffs. It now appears that we will meet by March 31, our goals to reduce nonaccruals by 50 percent and sell 50 percent of our acquired property which we thought would take a year to complete.

Because of the success of Phase I, we are currently testing Phase II which will be another series of bold moves to return the Seventh District to financial health. Our new goals will continue to keep the good producer on the land which will stop the influx of acquired property. At the same time, we will continue to sell real estate without driving down land values any further. The culmination of these events will enable us to reduce our interest rates closer to competitive levels for all of our borrowers in 1987.

There is one major problem we have at the moment and that is the flight of our best borrowers. During 1986, the Land Banks and PCAs lost $1.2 billion in loans primarily because our interest rates have been uncompetitive and farmers are concerned about their stock. We have still not solved the loss of business and perhaps you, in your deliberations, could reaffirm congressional intent to support the Farm Credit System during these difficult times.

If you can do that, I will assure you that the hard work and dedication of all the employees in the Seventh District will continue. I think you would agree to date, their success has been very encouraging and beneficial to farmers and agriculture in our four states.

STATEMENT OF H. BRENT BEESLEY, CHIEF EXECUTIVE OFFICER, FARM CREDIT CORPORATION OF AMERICA, AND MEMBER, THE FARM CREDIT COUNCIL

Mr. Chairman and Members of the Subcommittee. My name is Brent Beesley. I am the Chief Executive Officer of the Farm Credit Corporation of America and a member of The Farm Credit Council's Legislative Committee. I appreciate this opportunity to testify today.

The Farm Credit Corporation of America was organized in July 1985 by the 37 Farm Credit banks to establish policy on national issues and to be the System's national spokesman. At this moment, the three banks in the Texas District are not members of Farm Credit Corporation of America. All 37 banks, however, are members of the Farm Credit Council and have had the opportunity to review and comment on this testimony.

PURPOSE & PROFITABILITY

The Farm Credit System was created by Congress solely for the benefit of the farmers, ranchers and cooperatives of this nation. Everything that the 15,000 employees of the System do should accrue to the ultimate benefit of our 650,000 owner/borrowers.

Most of my statement today is about strengthening the Farm Credit System and returning it to profitability. Unless the System can be profitable in the long-run, it will either eventually fail or be permanently subsidized. There are no other alternatives. We do not believe for one moment that the System should be permanently subsidized. We do believe, however, that the Farm Credit System can best serve the American farmer, rancher and co-op by striving over the long-term to make this cooperatively owned credit delivery system profitable.

I would be remiss if I did not point out the obvious: the financial health of the Farm Credit System is inextricably linked to the economic health of agriculture. If there is not a significant improvement in net farm income, the ability of farmers to repay their loans will be jeopardized and that in turn will worsen the financial health of this System. We are a mirror of the agricultural economy.

Mr. Chairman, the vast majority of the System's owner/borrowers are paying their loans, according to their respective agreements. Many are doing so at great sacrifice.

Hundreds of these farmers and ranchers serve as directors and set the policies of their respective banks or associations. I answer to a 12-member board, each of whom is an owner and borrower of the System. I can assure you they set the policies and directions of the Farm Credit Corporation of America.

The board-directed efforts to strengthen the System for all its farmer-borrowers, present and future, will inevitably conflict with the personal interests of some borrowers. Elected officials, however, will rarely hear from those farmers who are current in their payments, or those whose loans have been successfully restructured or those who have checked out the competition and found the System's rates to be fair.

Mr. Chairman, I believe most of our borrowers understand that the System must be managed in a business-like manner. The policies we are currently following in every case are established by directors who have been elected by their fellow farmers, ranchers and cooperatives.

DIVERSIFIED SYSTEM

While we often speak of the Farm Credit System as if it were a single entity, we must remember that this System consists of 387 associations and 36 banks which are organized into 12 districts. There are also a Central Bank for Cooperatives and 5 service entities for a total of 429 separate legal entities. (Attachment A is a district-by-district summary of the associations in the System as of January 1, 1987, a history of the consolidation that has occurred among associations since 1941 and a map outlining the territorial boundaries of the 12 Farm Credit districts.) Each of these institutions has a farmer-elected board of directors with fiduciary responsibilities. The exercise of these legally binding responsibilities is often misinterpreted.

While there is healthy diversity within the System on some issues, the entire System shares a common vision of the vital role of the Farm Credit System in the future of American agriculture. We are also united in our appreciation to Members of Congress who worked to craft the Farm Credit Act Amendments of 1986, passed in the waning hours of the 99th Congress. Without that legislation, the System would be in a real crisis today.

Mr. Chairman, as I understand it, one of the principal purposes of this hearing is to provide you and the members of the Subcommittee an accurate assessment of the current financial condition of the Farm Credit System and an overview of some of the critical issues we face.

CURRENT SITUATION

Attachment B is a series of graphs, charts and district-by-district financial statements which illustrate various aspects of the System's financial condition as of December 31, 1986, on a GAAP (Generally Accepted Accounting Principles) basis.

As you know, the System reported a $1.9 billion loss for the year 1986, compared to a loss of $2.7 billion in calendar 1985. These losses are a function of three primary factors, provisions for loan losses, the level of nonaccrual loans and acquired property and our excess interest expense.

PROVISIONS FOR LOAN LOSSES

First is the large provisions for loan losses. Provisions for loan losses were $1.8 billion in 1986 and $3.0 billion in 1985. This has occurred after seventy years of virtually no loan losses. In 1985 and 1986, the System's total provision for loan losses was $4.8 billion. *It is very important to understand that this extraordinary provision for loan losses has been the primary reason for a total net loss of $4.6 billion during this same period.*

These large provisions have been made because of the analysis of the System's loan portfolio and the economic factors affecting it, namely, declining land values, commodity prices and net farm income.

The inability of many borrowers to make their payments has thrown the Farm Credit System into a period of unprecedented financial difficulty. For perspective, however, loan losses in the System have been about the same as the losses in the agricultural portfolios of other lenders.

During the last five years, the value of American farm land has fallen 60 percent in certain areas and an average of 30 percent nationwide. (Attachment C contains a chart which depicts these declines by region.)

Procedures for evaluating the System's loan portfolio have continued to improve in the last several months. Our assessment of the System's loan portfolio and the economic factors affecting it has compelled us to build these large allowances for loan losses. We believe, however, that the present allowance of $3.6 billion is adequate unless there is further deterioration in the financial condition of our borrowers. Based on this analysis, the future net losses of the System should be significantly reduced from the levels of 1985 and 1986.

NON-ACCRUING LOANS AND OTHER HIGH-RISK ASSETS

The second factor causing the System's large losses in the last two years is the high level of non-accruing loans. As of December 31, 1986, non-accruing loans totaled $7.1 billion, compared to $5.3 billion at December 31, 1985.

Other high-risk loans which still accrue interest but have been identified as potential problems totaled approximately $5.7 billion at December 31, 1986, compared to approximately $4.0 billion at December 31, 1985. Included in this other high-risk loans category at December 31, 1986, are $1.0 billion of loans 90 days or more past due but which are well secured and in the process of collection.

Other property owned increased to $1.1 billion at December 31, 1986, from $928 million at December 31, 1985. Losses on other property owned in 1986 and 1985 were $233 million and $285 million respectively. (Attachment D contains charts and other information regarding non-accruing loans, other high-risk loans and acquired properties on a district-by-district basis.)

The System's volume of non-accrual loans, high-risk loans and acquired property reflects the inability of many of our borrowers to service or repay their loans in the current environment. These non-earning and high-risk assets represent a significant drain on System resources.

EXCESS INTEREST EXPENSE

The third factor causing the System's large losses is our high cost of debt. The System's interest expense during 1985 and 1986 was nearly $4.9 billion higher than it would have been had it been paying current market rates on this debt. *It is very important to understand that most of this high cost debt will be paid off over the next several years.* (Attachment E outlines the runoff of our high cost debt and indicates the past and projected annual excess interest expense over current market levels.)

According to figures recently published by the Federal Farm Credit Banks Funding Corporation, in the 14 months from June 1980 to August 1981, six-month interest rates rose from 7.9 percent to 17.9 percent. In a subsequent 12-month period, the rates dropped 8.2 percentage points. These are enormous swings by any historical standard. (Attachment F is a graph depicting this volatility in interest rates.) In hindsight, the funding strategies used by the System were inadequate in an environment characterized by this unprecedented volatility in interest rates.

Mr. Chairman, with total provisions for loan losses of $4.8 billion in 1985 and 1986 and excess interest expense of $4.9 billion, it is very important to note that the System losses were "only" $4.6 billion. In other words, if only one of these extraordinary problems had occurred, the System would have been profitable during even this most difficult period in its long history.

REGULATORY ACCOUNTING PRACTICES

Regulatory Accounting Practices (RAP), as provided in the Farm Credit Act Amendments of 1986, authorize the Farm Credit Administration to allow System entities, as of July 1, 1986, to spread their losses related to these extraordinarily high provisions for loan losses and high debt cost over a period of up to 20 years. I consider RAP to be an appropriate basis for financial accounting in the System under present circumstances. RAP may even be more reflective of the real strength of the System than GAAP. All the figures used above, however, are prepared on a GAAP basis even for the period after July 1, 1986. Had RAP been used in 1985 and 1986, the System would have had only nominal losses.

FUTURE PERFORMANCE

The Farm Credit System has a Business Plan which addresses each aspect of our operations. Mr. Chairman, the System is making progress to correct its operational deficiencies, many of which you have pointed out to us. Much change has occurred during the last twelve months; some areas are changing faster than others.

One of the more than 45 business strategies in the Business Plan is the development of periodic forecasts of the System's future financial condition.

As you know, forecasts of System financial conditions have been provided in previous testimony in the fall of 1985 and again in 1986. The accuracy of these forecasts has been very good, considering the many variables involved.

The latest round of forecasts will be completed in mid-April. They will be the best we have ever produced. We are utilizing improved procedures to assure uniformity and consistency throughout the System. Upon completion of these forecasts, we will promptly review them with Members of this Subcommittee.

Until the next forecast is complete, we continue to use the projections presented to the Congress last fall. These projections were as follows:

On a GAAP basis, the loss for 1987 was projected to be approximately $1.1 billion and approximately $600 million for 1988.

GAAP surplus, which was $3.4 billion at December 31, 1985, and $1.5 billion at December 31, 1986, was projected to decline to $600 million at December 31, 1987, and a negative $100 million at December 31, 1988.

Net loan volume which was $66.6 billion December 1985, and $54.6 billion December 1986, was projected to be about $52.1 billion at December 31, 1987 and $46.8 billion at December 31, 1988.

On a RAP basis, System losses will, of course, be much less. Using RAP and absent further deterioration in the financial condition of our vulnerable borrowers, I do not expect the System's remaining surplus to be depleted on a consolidated basis before a turnaround occurs.

In evaluating my last comment, I hope that members of this Subcommittee will appreciate that several uncontrollable factors may significantly impact System earnings and therefore its surplus position. These factors include changes in general levels of interest rates, Federal farm programs, land values, and commodity prices. Some of these factors change daily. All are impossible to predict with any degree of certainty.

The consolidated numbers presented above mask the true picture of the System's financial condition, past and future. Yes, the System's consolidated numbers are quite encouraging, especially on a RAP basis, but a significant number of banks and associations in the most economically depressed areas have and will continue to suffer extraordinary losses. The System's current forecasting and financial planning efforts will include an evaluation of the viability of all Farm Credit System entities and an analysis of the most appropriate and cost effective methods of dealing with the distressed situations.

Most important, we consider that the tools provided in the 1986 Amendments give all concerned, including the Congress and Administration, the necessary time to address these matters in a non-crisis atmosphere.

FEDERAL FINANCIAL ASSISTANCE

Until our latest projections and analysis are completed, it is inappropriate to draw any conclusions about any potential needs for Federal financial assistance or the timing of that assistance. I can report, however, that it remains the position of the System to try to avoid or minimize the need for Federal financial assistance.

Mr. Chairman, at this time, we are continuing to meet with officials of the Farm Credit Administration, the Department of Treasury, the Wall Street community and others to explore ways to resolve our current difficulties without the need for Federal financial assistance. *The System's ability to avoid the need for Federal financial assistance depends on our success in working with the Farm Credit Administration to maintain owner-borrower confidence during the workout period.*

However, *if* there comes a time when Federal financial assistance is needed, the System supports the mechanism provided in the 1985 Amendments whereby the Farm Credit Administration would certify to the Treasury the System's need for such assistance and Treasury would request Congress to appropriate the necessary funds.

PAST CONGRESSIONAL ACTIONS

We do not underestimate the severity of the financial difficulties facing the Farm Credit System and American agriculture. Congress and the Administration have made it clear that they consider the Farm Credit System to be an important element of this nation's greatest industry. Within the last sixteen months, Congress has passed and the President has signed two very important laws which were intended to help farmers and ranchers by strengthening their cooperative credit delivery System.

The Farm Credit Act Amendments of 1985 and 1986 were designed to provide the System and its regulator, the Farm Credit Administration, with the necessary tools to accomplish the following important objectives.

1. Provide additional means by which the System's available resources can be deployed to protect the stock investment of its members.
2. Allow System entities to price their loans on a locally competitive basis.
3. Buy time for the System to work out of its problem loans and high cost debt.
4. Reassure the investors in System obligations that their investments are sound.

SYSTEM BUSINESS PLAN

In May of 1986, the System adopted its first Farm Credit System Strategic and Business Plan. This plan and the objectives and strategies contained therein are on record.

Substantial progress has already been made in virtually every area of System operations, as outlined in the Business Plan. Overhead expense is down $90 million or more than 10 percent in 1986. The number of employees has been reduced by 3,100 or 17 percent during the last two years. Our credit skills are improving. We are managing interest-rate risk better than ever before. Our financial accounting, forecasting and disclosure are also much improved.

MANAGEMENT AND DIRECTORATE

Another important factor in the System's improved performance has been the dedication of its management and directorate. I've served on numerous boards of directors and found few of my former colleagues to be as concerned and willing to work as the directors of the Farm Credit System. The farmers and ranchers on these boards are setting the appropriate policies and directions.

It is also noteworthy that the System has attracted several highly trained and capable managers to key positions during the last year. More than half of all bank and service entity presidents are new, and one-third have come from the commercial banking sector. They have brought new dedication and commitment to the System. (Attachment G contains the names of the System bank and service entity presidents and the date they assumed their current responsibilities.)

I want to add a special word of recognition to the employees of the System who are working in the banks and associations. They are talented, competent and dedicated to the farmers they serve. These employees are working under very stressful conditions.

COMPETITIVE RATES

As a result of the Farm Credit Act Amendments of 1986, every Farm Credit System institution has the authority to set its interest rates at locally competitive levels. There is absolute agreement in the System that competitive rates are critically important to farmers during these difficult times. The real importance of giving the System authority to be competitive is that never again should loan rates be kept artificially high and result in the System's strongest borrowers taking their business elsewhere or causing our struggling borrowers to become angry and frustrated with a System which they own.

I am pleased to report that today most banks and associations are pricing loans on the basis of the competition. In the marketplace, however, credits with the least risk demand the lowest rate. That principle applies in every industry. However, rates in some areas are still too high. (Attachment H is a summary of the current prices in each district.)

With the authority to set rates competitively comes the responsibility to never again price loans below market as has been done from time to time in the past. Yes, lower rates will always appeal to our borrowers and your constituents, but below-market rates will almost always result in problems down the road. Many of the problems we face today, both as borrowers and as a System, would have been reduced or avoided had the System kept its rates at competitive levels in the 1970's and early 1980's. Below-market rates fueled excessive debt, land speculation and artificial escalation in land prices. The loan value of the System was driven up to unsustainable levels, other lenders were disrupted and income which would have strengthened our reserves was never earned. (Attachment I graphically depicts the below-market rates charged by the System during the last 9 years.)

MARKET SHARE

One of the critical factors impacting the System's recovery is its loan volume. In the past two years, loan volume has declined by $21.6 billion. Some decline in loan volume is expected in this economy. Most disturbing, however, is that the System's share of the agricultural credit market has also declined. (Attachment J illustrates the decline in total credit and in the System's share of the market.)

Significant actions are being taken by the System to maintain its market share. Unfortunately, we are not able to resolve this matter alone. Negative statements in the media, attributed to government officials, about the safety of members' stock have been very detrimental to System efforts to build borrower-owner confidence and to retain market share.

LITIGATION

There has been a great deal of attention paid to the numerous lawsuits recently filed by and between various System entities. (A summary of this litigation is listed in Attachment K.) These suits are used by some outside the System to portray the System as being in disarray. This is not the case. The System is united on most of the issues involved, and the Farm Credit Administration is the primary defendant in virtually all these cases. Most of the lawsuits claim that the Farm Credit Administration's Assessment Regulations are invalid because they ignore some important mandates of the 1985 Amendments. This position has been confirmed by a recent decision of the Massachusetts Federal District Court.

On August 18, 1986, I wrote FCA Board Chairman Frank Naylor, about the System's concerns regarding the legality of the assessment regulations.

> "The urgent needs of those System institutions presently experiencing severe financial stress may not be met if the Farm Credit Administration's [Assessment] regulations are determined to be invalid. Indeed, the entire System will suffer if the self-help efforts mandated by the 1985 Amendments are frustrated by court determinations that Farm Credit Administration's regulations do not carry out the intent and mandate of the 1985 Amendments. The essence of that mandate is that System institutions must be in a position to provide credit to eligible borrowers on reasonable and competitive terms.
>
> "Congress recognized that it would make no sense to require contributions from any System institution that could not provide that level of service to its borrowers.
>
> ". . . the regulations, as presently written, are vulnerable to serious challenge and should promptly be revised in order to comply with the statutory

direction given to FCA in Section 4.28G of Farm Credit Act of 1971, as amended." (Attachment L is the complete text of this letter.)

My letter was never answered, and unfortunately our worst fears about these regulations have been realized.

FARM CREDIT SYSTEM CAPITAL CORPORATION

The lawsuits filed at the time of the Capital Corporation's $296 million assessment attacked the Farm Credit Administration's regulations, not the Capital Corporation or the notion of sharing capital. Indeed, since the assessment was levied on September 29, 1986, the System has *voluntarily* shared $239 million more of its surplus. This is in addition to the $869 million *voluntarily* shared before the assessment was levied. However, few managers or directors, faced with clear fiduciary obligations to their own stockholders, were willing to pay the Capital Corporation's assessments because they were based on regulations that were clearly inconsistent with the language of the 1985 Amendments. Many of those who did pay the assessment did so under protest.

Contrary to the perceptions of many, the vast majority of the System wants the Capital Corporation to be successful. You will recall that the System itself had organized the original Capital Corporation in 1984 as a tool of self-help. This concept was embodied in the 1985 Amendments, and the original Capital Corporation was rechartered. Despite the lobbying efforts of the old Farm Credit Administration to the contrary, Congress determined that the Capital Corporation was to be owned by the System and controlled by the System until such time as Federal financial assistance is provided. Yes, we want the Capital Corporation to be effective. The System needs it, but it must function as intended by law.

Furthermore, Mr. Chairman, we are concerned about the Farm Credit Administration's actions to separate the Capital Corporation from the remainder of the Farm Credit System. For example, FCA regulations prohibit many of the most able and dedicated System leaders from serving on the Capital Corporation board of directors simply because they serve or have served on the Farm Credit Corporation of America Board of Directors.

REGULATORY ACCOUNTING PRACTICES (RAP) REGULATIONS

The remaining lawsuits pertain to the RAP Regulations. While the January 26, 1987, technical corrections to these regulations resolved many of the System's concerns, there are still several provisions in the regulations that should be changed to achieve the objectives which Congress outlined in the 1986 Amendments. This morning, at a hearing at FCA, the necessary changes and the supporting arguments were communicated. (Attachment M is my testimony at the FCA hearing.)

It would be of marginal value, however, to amend the RAP Regulations only. We must work together to develop a broader solution to all the lawsuits and the borrower confidence issue. This solution will require a cooperative effort by FCA and the System to develop regulations that conform to the 1985 and 1986 Amendments by permitting full use of RAP and by establishing a fair and equitable scheme for sharing limited System resources. The viability of healthy institutions within the System cannot be jeopardized. We recognize that this will call for difficult judgment and actions on the part of both FCA and the System.

A PROPOSED SOLUTION TO SETTLE LAWSUITS

The Farm Credit Bank presidents have embraced a proposal for a more complete solution. We are now working to develop this proposal more fully. (This concept has also been approved by the Board of Directors of the Farm Credit Corporation of America and the Legislative Committee of the Farm Credit Council.) The outline of this proposal solution is as follows:

1. The Farm Credit Administration would amend its Assessment Regulations to conform to the 1985 Amendments. This might result in a single, up-front assessment by the Capital Corporation and an equitable formula for future assessments if necessary. For this to work, Farm Credit System entities must know that the limits placed on these assessments will allow them to remain viable and to provide credit to their members on a competitive basis.

2. The Farm Credit Administration would amend the RAP Regulations to allow full utilization of RAP before the scarce resources of the Capital Corporation are deployed. Currently, the Capital Corporation must certify that it is unable or unwilling to provide assistance before the full use of RAP can be applied.

3. The Farm Credit Administration would amend the RAP Regulations to allow the unwinding of the assistance voluntarily shared among System institutions back to February 23, 1986, the date on which the Capital Corporation was rechartered, pursuant to the 1985 Amendments. Amounts taken from receiving banks for the period February 23, 1986, through June 30, 1986, would be replaced on similar terms by the Capital Corporation. Amounts returned to contributing banks would be considered for assessment pursuant to the amended assessment regulations.

4. The System would utilize its own internal mechanisms to help ensure compliance by all System entities. There has been little enthusiasm to bring such pressures to bear to date as every District is on record as believing that the current Farm Credit Administration assessment regulations are invalid and illegal.

5. The Farm Credit Administration would make it clear to all concerned that if and when the full utilization of RAP and the full utilization of the available resources of the Capital Corporation are not sufficient to ensure that System institutions can still provide competitive interest rates to borrowers, the Farm Credit Administration would certify the need for federal financial assistance to the Treasury as outlined in the 1985 Amendments. This is not intended to imply that every System entity has a right to survive. We consider it appropriate for the Farm Credit Administration and/or the Capital Corporation to restructure non-viable entities. At the same time, we believe that it makes good business sense and is consistent with the clear intent of Congress reflected in the 1985 and 1986 Amendments that the members' stock be protected. We believe such support by the Farm Credit Administration will help eliminate or minimize the actual need for Federal financial assistance by reassuring the System borrower/owners and thereby helping the System to retain market share.

6. If necessary, the 37 Farm Credit System banks would agree to share collateral.

While there may be some entities that will resist parts of this proposal, from the System's viewpoint, a solution along these lines is feasible. The solution would permit the Farm Credit System Capital Corporation to fulfill its intended role, result in the settlement of most of the lawsuits filed and judgments entered against the Farm Credit Administration and would also increase borrower confidence in the System.

BORROWER STOCK

We do not consider it necessary or appropriate to ask Congress for any additional legislation until the Farm Credit Administration and the System have fully implemented the powerful tools that Congress has provided to the System. However, if the System is to continue its 70-year-old role as a farmer-owned and controlled source of dependable and fairly priced credit, we must be able to provide greater assurance to our borrowers that their stock is safe. These borrowers are not investors in the traditional sense. They have no choice in the price they pay for their stock. They have no choice in the Farm Credit System entity from which they borrow. In many cases, the losses suffered by their local institution are solely the result of sharing capital with distressed institutions far away and have little to do with the performance of their own institutions.

SYSTEM STRUCTURE

The current Farm Credit System structure has four basic flaws. These flaws may not be signficant in good times, but they are very serious in the current environment.

1. System managers and directors have a clear duty to their respective stockholders while at the same time they are contractually, legally, regulatorily, and to some degree politically expected to act as a single system when it comes to sharing vital surplus.

2. System entities are contractually and statutorily impacted by losses in far away places without the control mechanisms to assess and manage those losses effectively.

3. The System lacks the ability to make rapid and decisive decisions in a volatile and competitive environment which demands quick decisions and action.

4. Despite significant achievements in the reductions of overhead expense, inherent structural duplication and redundancy remain within the System, and it is difficult to achieve economies of scale.

The capitalization of the System should also be addressed at some point to provide for more permanent risk capital. Legislation may be in order regarding the structure and capitalization of the System. Note, however, that many changes have already been made by the System. The borrower/owners, directors and management of the System are working on the structure and capitalization issues. When these matters are ripe for legislative action, the System will be ready with its proposals. We will be far more united than many outside the System currently anticipate.

SECONDARY MORTGAGE MARKET

We consider that a secondary mortgage market for agricultural loans could have several benefits for farmers and lenders alike. Of greatest benefit to the farmer would be the increased availability of long-term, fixed-rate loans at more competitive rates. The interest-rate risk associated with these credits would be passed through to the investors through the secondary mortgage market. Of greatest benefit to the lenders would be the increased marketability of their loan portfolios and their increased ability to manage interest-rate risk.

The creation of a secondary mortgage market facility outside the Farm Credit System would most likely have a negative impact on the Federal Land Bank Associations. Therefore, the Farm Credit System has been working with representatives from the other major agricultural lenders, including trade associations of the banking and insurance industries, to consider the development of a secondary mortgage market facility within the Farm Credit System. We have also been visiting with officials from the Farm Credit Administration and the Department of Agriculture. They appear to be supportive of our efforts, and we are pleased with the progress made to date. We believe that the System currently has sufficient statutory authorities to become the secondary mortgage market facility and to perform the role of a "credit enhancer" for this new market.

AGRICULTURAL INTEREST-RATE RELIEF ACT OF 1987

Mr. Chairman, I have studied S. 57, the "Agricultural Interest-Rate Relief Act of 1987." If the government should elect to pay all or part of a borrower's interest expense, most lenders, including the Farm Credit System, would be pleased.

The provisions in S. 57 regarding loan restructuring and acquired property are indeed similar to existing Farm Credit System policies. These policies have been widely disseminated and are of record with the Senate Agriculture Committee. It takes time for new policies to be consistently implemented throughout the System. However, much progress has been made in a short period of time. Hundreds of people are now assigned full-time to this effort, and we expect much greater results in 1987. (Attachment N summarizes the forbearance and loan restructuring policies in each district and the results achieved in this regard during 1986.)

There is considerable risk in Congress establishing detailed operating policies and procedures for any business enterprise. Conditions change, circumstances differ and judgment must be used by those who are being held accountable and responsible. For example, our policy on loan restructuring clearly states that foreclosure should be the last alternative. However, the following additional factors regarding loan restructuring are also part of the policy:

1. The borrower has acted in good faith to manage his business affairs and has been cooperative with the banks or association;
2. The borrower can present a plan with reasonable assumptions showing a high probability of return to financial viability as a result of the restructuring; and
3. The alternative chosen will minimize any loss that will be borne, by the other borrowers/stockholders of the bank or association.

Attempts to legislate this type of business judgment will result in endless litigation. Further, there is already an appeal procedure established for those borrowers whose loans are not restructured as they consider appropriate.

Farmer ownership and control of the System provides the sensitivity and safeguards S. 57 rightly seeks, while allowing good business judgment to be utilized as circumstances require.

CURRENT NEED FOR THE FARM CREDIT SYSTEM

American agriculture will always need a dependable and fairly priced source of credit *during every phase of the business cycle.* The Farm Credit System is the best mechanism to ensure that the American farmers, ranchers and their cooperatives have a consistent supply of funds—rain or shine. *Long-term profitability and farmer ownership and control of the System are our best guarantees of that dependability.*

Today, more than ever, American agriculture needs the Farm Credit System, because more and more lenders are taking their money elsewhere. Whether one borrows from the System or not, our presense is vital to a dependable and competitively priced agricultural credit market. Every farmer, rancher and cooperative who uses credit from any source has a stake in our future.

CONCLUSION

The Farm Credit System and its farmer/owners have suffered dearly during the last two years from erroneous and negative information attributed to government officials. But as Mark Twain reportedly said, "Reports of [our] demise are greatly exaggerated." The Farm Credit System has the plans, programs, policies and most importantly, the people to meet the challenges we face.

As we resolve our current difficulties, even our competitors recognize our potential. A recent American Bankers Association's publication, *Transition in Agriculture: A Strategic Assessment of Agriculture and Banking*, said:

> As of mid-1986, the Cooperative Farm Credit System was experiencing difficulties adjusting to some of these changes—difficulties which must be overcome before the system can achieve its potential . . . However, if and when these new goals and levels of performance are achieved, the Cooperative Farm Credit System will ultimately emerge from its present difficulties with its advantages still largely intact and with changes in structure and procedures which should strengthen its competitive position in total farm lending.

There are difficult times for all concerned. From the farmer who has more debt than he can service, to the overworked loan officer who is trying to help his friends and neigbors caught in financial difficulties, to the financially strong borrower who worries that his stock might be in jeopardy, to the new regulator or examiner who is trying to adjust to unfamiliar powers and responsibilities—everyone is under great stress.

In these times particularly, we greatly appreciate and are comforted by the interest and concern which you, Mr. Chairman, and the members of this Subcommittee have in the Farm Credit System and its 650,000 farmer, rancher and cooperative borrower/owners. Thank you.

Attachments A-N follow:

Attachment A
Page 1

PCA AND FLBA CHARTERS

Year	PCAs	FLBAs	Total
1941	530	3,801*	4,331
1951	500	1,202*	1,702
1961	488	791	1,279
1971	442	594	1,036
1981	424	492	916
1984	412	470	882
1987 (January 1)	155	232	387

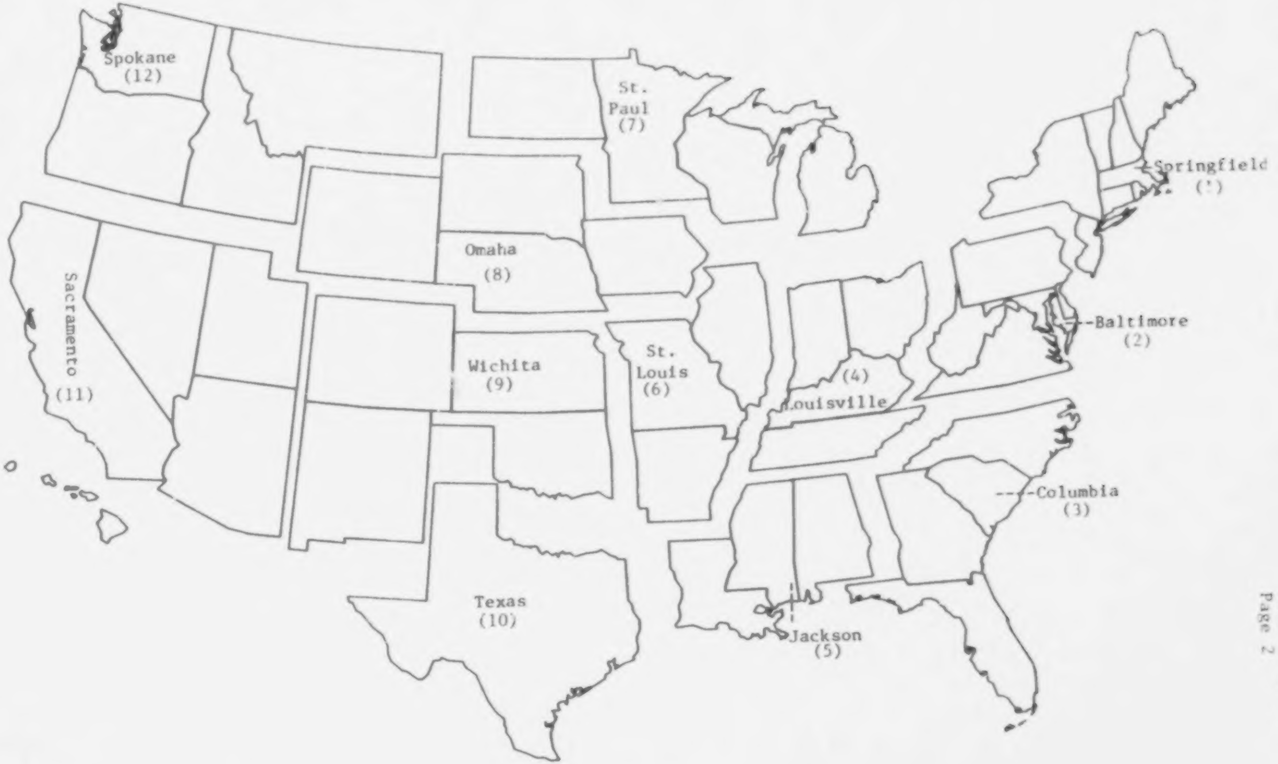
*National Farm Loan Associations - later evolved into the Federal Land Bank Associations.

Association Charters
January 1, 1987

District	PCAs	FLBAs
Springfield	18	18
Baltimore	26	26
Columbia	1	20
Louisville	6	9
Jackson	2	1
St. Louis	4	21
St. Paul	24	26
Omaha	1	31
Wichita	18	15
Texas	28	44
Sacramento	25	20
Spokane	2	1
	155	232

Attachment A
Page 2

TERRITORIAL BOUNDARIES OF THE 12 FARM CREDIT DISTRICTS


Spokane
(12)
St.
Paul
(7)
Springfield
(1)
Omaha
(8)
Sacramento
(11)
Wichita
(9)
St.
Louis
(6)
(4)
Louisville
Baltimore
(2)
Columbia
(3)
Texas
(10)
Jackson
(5)

Attachment B
Page 1

FARM CREDIT SYSTEM

ANALYSIS OF DECEMBER 31, 1986 FINANCIAL RESULTS AND CONDITION

* * * * *

FARM CREDIT CORPORATION
OF AMERICA

FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

RESULTS OF OPERATIONS

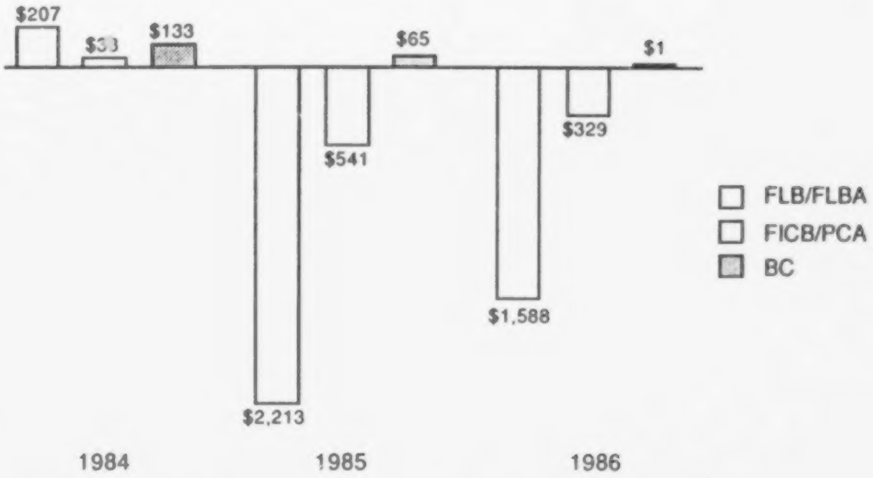
STATEMENT OF OPERATIONS DATA
($ Millions)

	1984	1985	1986
Net Interest Income	$ 1,453	$ 1,295	$ 781
Provision for Loan Losses	(335)	(2,969)	(1,798)
Provision for Losses on Other Property Owned	(25)	(285)	(233)
Other Expenses, Net	(720)	(730)	(663)
Net Income (Loss)	**$ 373**	**($2,689)**	**($1,913)**

FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

RESULTS OF OPERATIONS

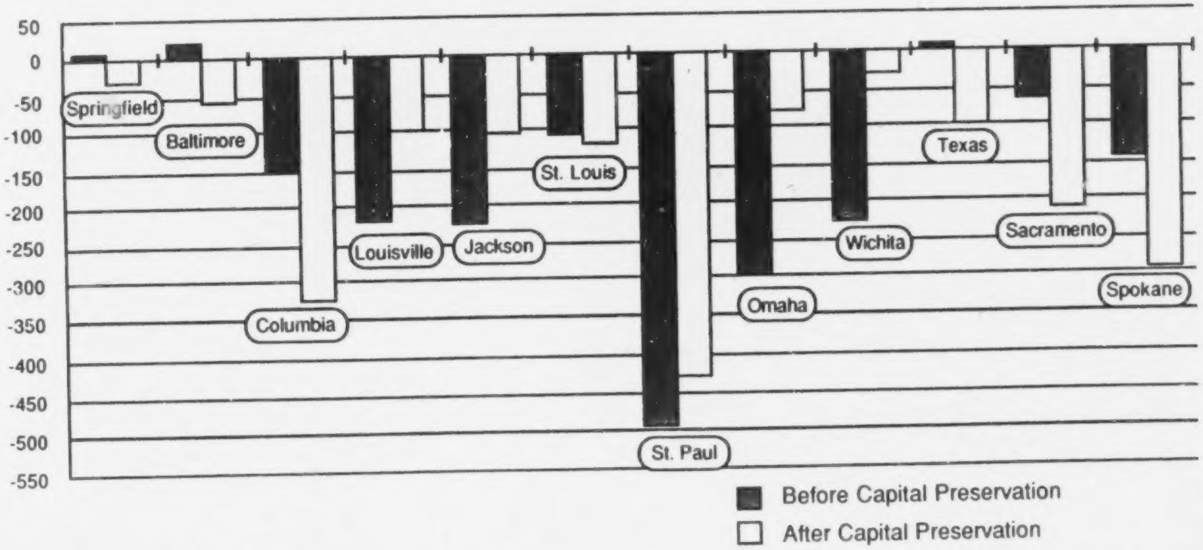
NET INCOME (LOSS) BY BANK GROUP
($ Millions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

RESULTS OF OPERATIONS

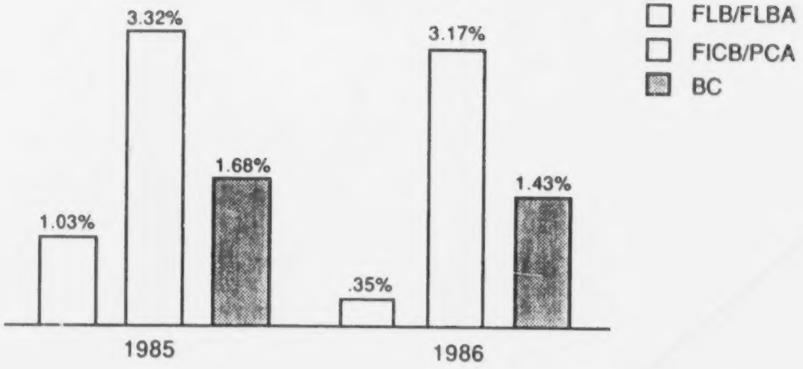
NET INCOME (LOSS) BEFORE AND AFTER CAPITAL PRESERVATION BY DISTRICT YEAR ENDED DECEMBER 31, 1986 ($ Millions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

RESULTS OF OPERATIONS

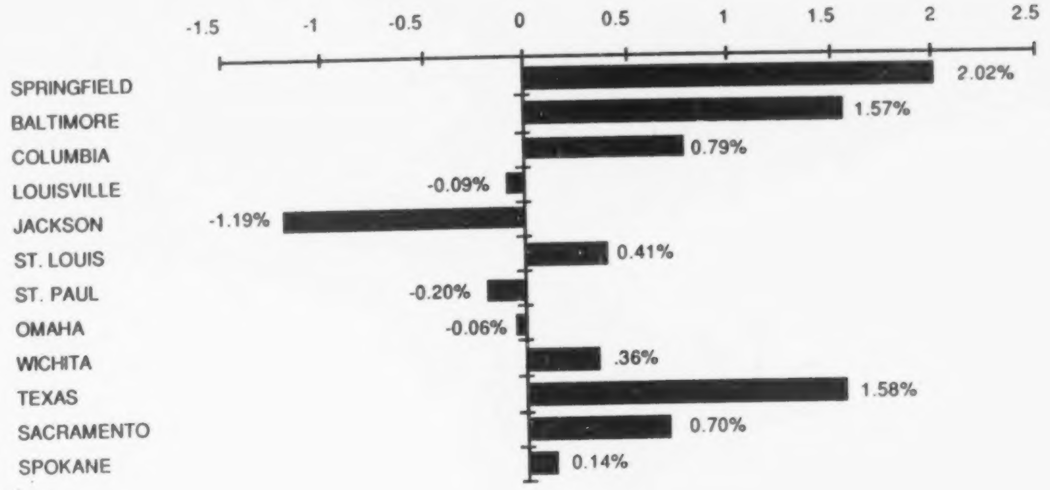
NET INTEREST INCOME TO AVERAGE EARNING ASSETS BY BANK GROUP



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

RESULTS OF OPERATIONS

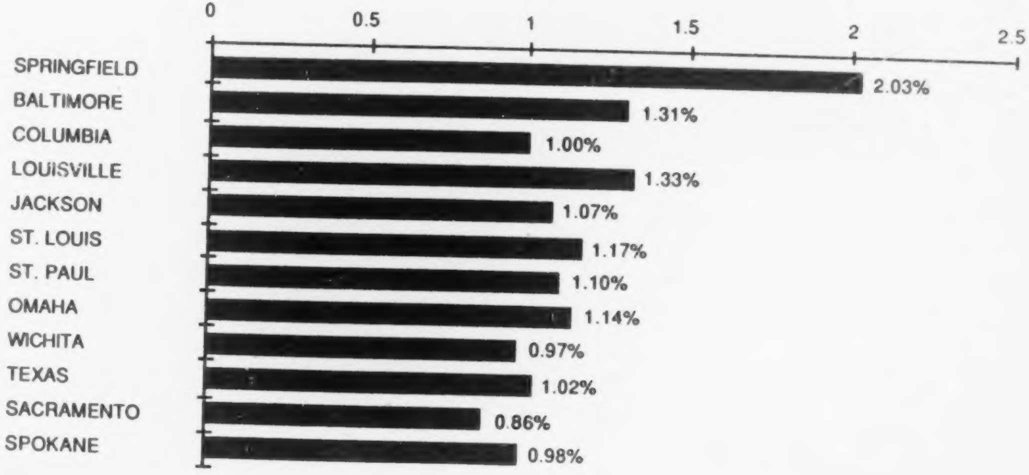
FEDERAL LAND BANKS AND ASSOCIATIONS
NET INTEREST INCOME (LOSS) TO AVERAGE EARNING ASSETS (ANNUALIZED)
YEAR ENDED DECEMBER 31, 1986



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

RESULTS OF OPERATIONS

OPERATING EXPENSES *, NET TO AVERAGE ASSETS BY DISTRICT (ANNUALIZED) YEAR ENDED DECEMBER 31, 1986

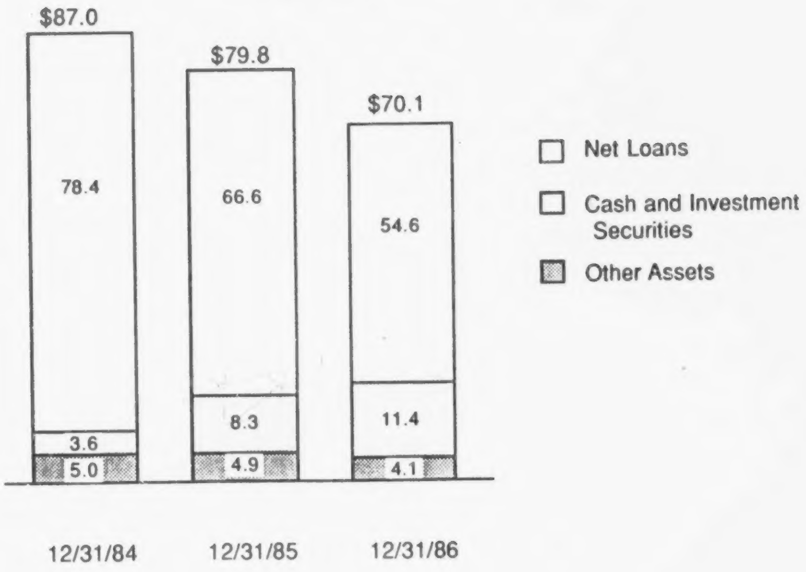


* Excludes losses on other property owned and intrasystem financial assistance

FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

FINANCIAL CONDITION

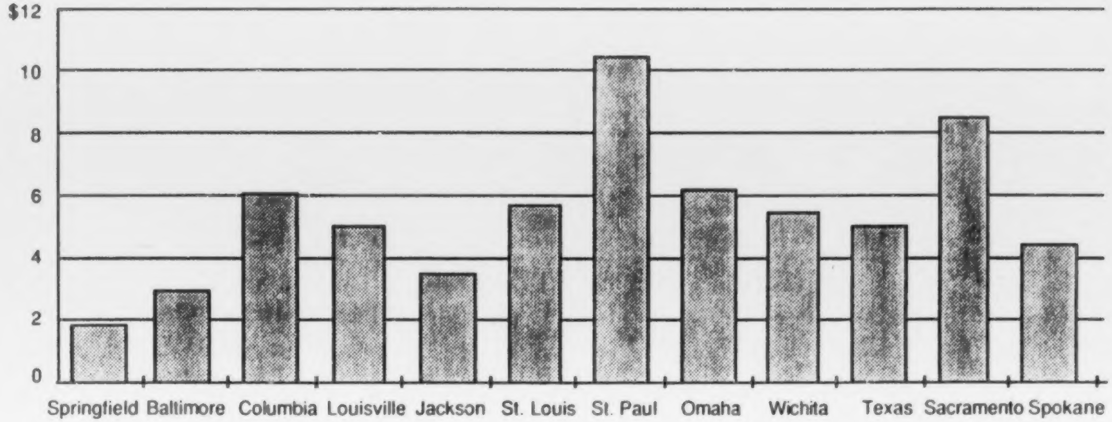
TOTAL ASSETS
($ Billions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

FINANCIAL CONDITION

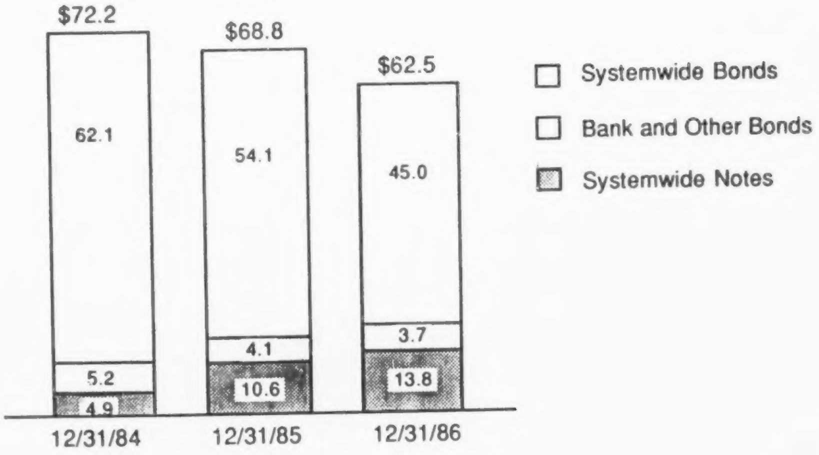
TOTAL ASSETS BY DISTRICT
DECEMBER 31, 1986
($ Billions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

FINANCIAL CONDITION

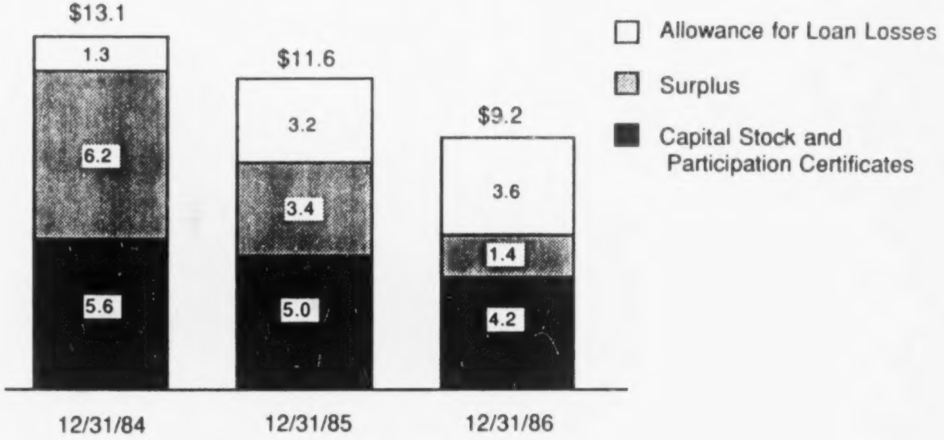
FARM CREDIT SECURITIES OUTSTANDING
($ Billions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

FINANCIAL CONDITION

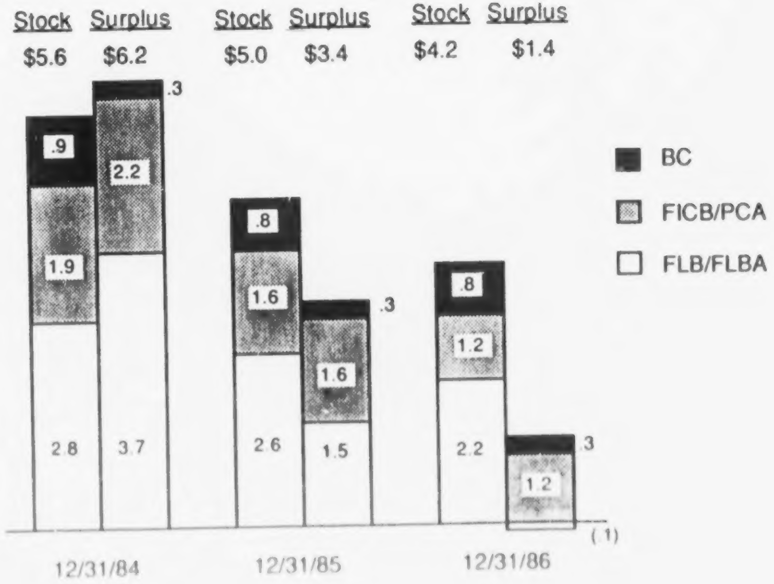
TOTAL RISK FUNDS
($ Billions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

FINANCIAL CONDITION

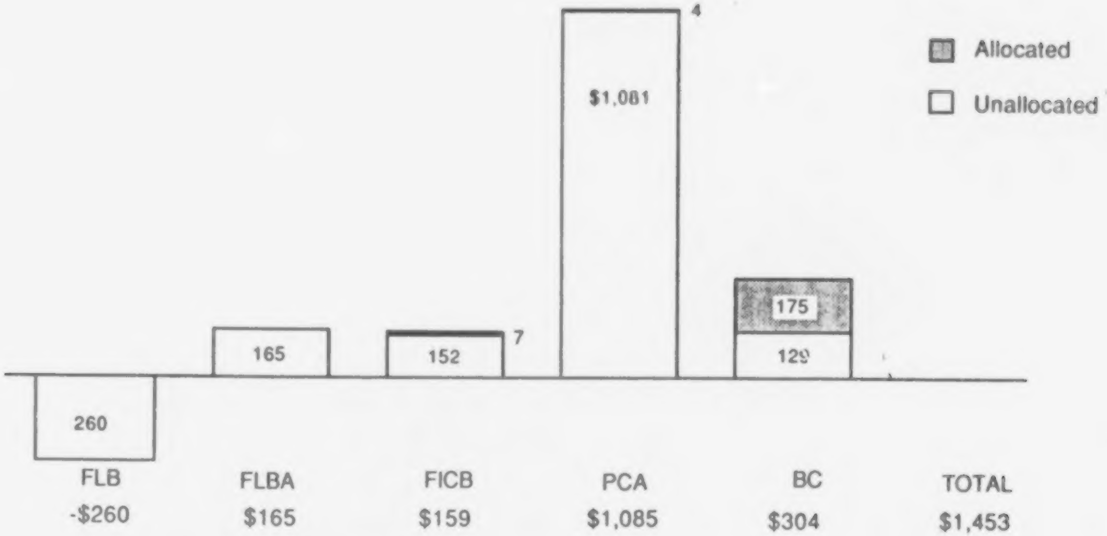
CAPITAL BY BANK GROUP
($ Billions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

FINANCIAL CONDITION

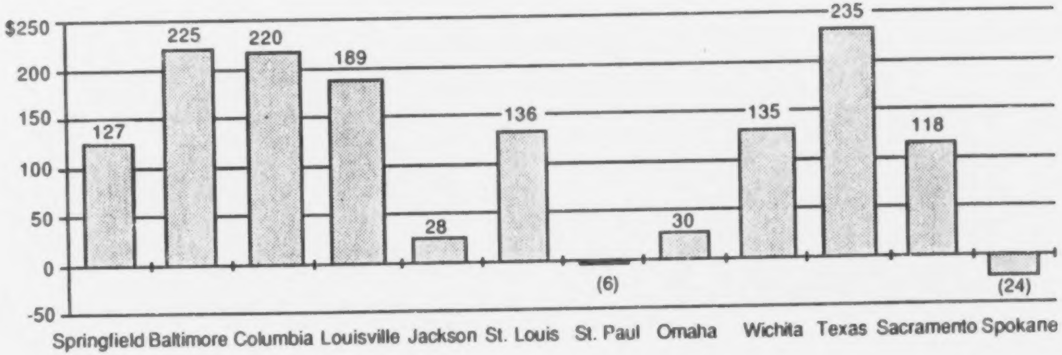
SURPLUS BY BANK AND ASSOCIATION GROUP
DECEMBER 31, 1986
($ Millions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

FINANCIAL CONDITION

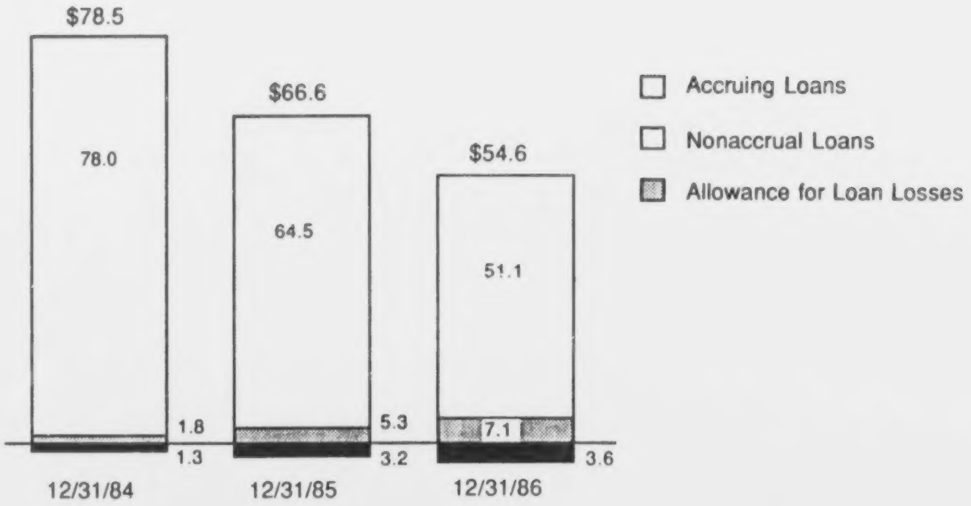
SURPLUS (DEFICIT) BY DISTRICT
DECEMBER 31, 1986
($ Millions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

CREDIT QUALITY

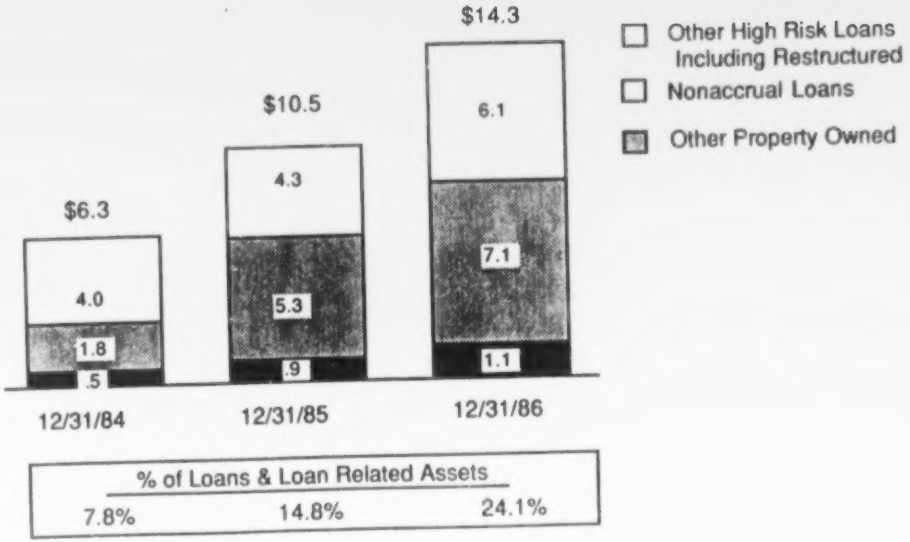
COMPONENTS OF NET LOANS
($ Billions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

CREDIT QUALITY

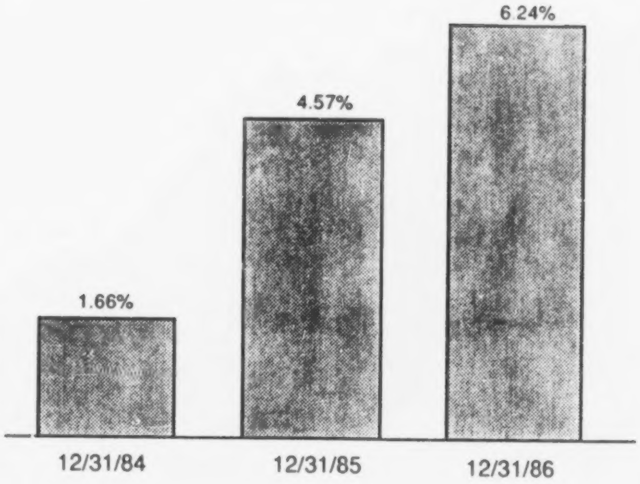
HIGH RISK ASSETS
($ Billions)



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

CREDIT QUALITY

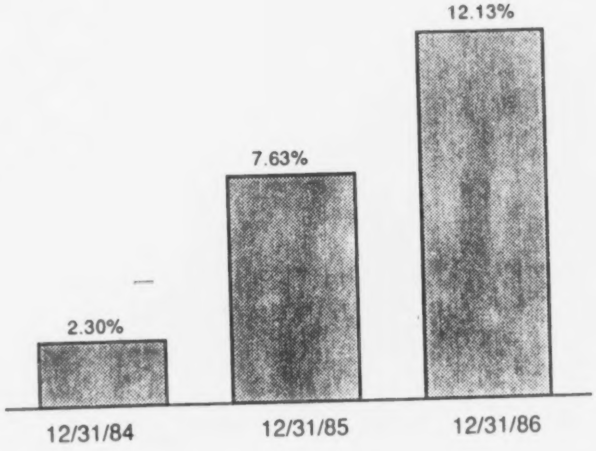
ALLOWANCE TO GROSS LOANS



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986
FINANCIAL RESULTS AND CONDITION

CREDIT QUALITY

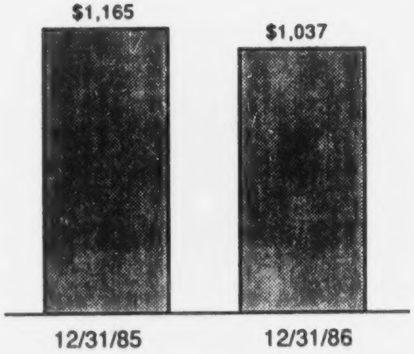
NONACCRUAL LOANS TO GROSS LOANS



FARM CREDIT SYSTEM
ANALYSIS OF DECEMBER 31, 1986 FINANCIAL RESULTS AND CONDITION

CREDIT QUALITY

LOANS 90 DAYS OR MORE PAST DUE AND ACCRUING INTEREST
($ Millions)



FEDERAL LAND BANKS/FEDERAL LAND BANK ASSOCIATIONS
COMBINED STATEMENT OF CONDITION
DECEMBER 31, 1986
($000)

ASSETS	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS	ST. PAUL	OMAHA	WICHITA	TEXAS	SACRAMENTO	SPOKANE	ELIMINATIONS	COMBINED
1) LOANS	834,435	1,843,177	4,042,540	3,102,185	1,938,087	3,849,811	5,815,751	4,317,912	3,914,277	2,383,622	4,197,312	3,046,593	0	39,285,702
2) ALLOWANCE FOR LOSSES	12,394	45,753	219,654	191,654	133,652	310,052	484,259	475,261	454,397	102,512	122,311	156,744	0	2,708,643
3) NET LOANS	822,041	1,797,424	3,822,886	2,910,531	1,804,435	3,539,759	5,331,492	3,842,651	3,459,880	2,281,110	4,075,001	2,889,849	0	36,577,059
4) CASH,INVEST.& NOTE REC.	121,405	219,174	462,700	366,982	395,584	638,791	1,013,183	807,189	576,886	653,131	654,950	323,241	(550,663)	5,682,633
5) TOTAL EARN. ASSETS	943,446	2,016,598	4,285,666	3,277,513	2,200,019	4,178,550	6,344,675	4,649,840	4,036,766	2,934,241	4,729,951	3,213,090	(550,663)	42,259,692
6) OTHER PROPERTY OWNED	5,499	3,352	52,713	44,357	99,587	88,161	195,956	135,623	90,590	10,791	111,066	72,549	0	910,244
7) OTHER ASSETS	34,357	53,500	184,790	198,992	113,799	215,472	278,661	282,104	202,982	158,441	252,568	223,682	0	2,191,340
8) TOTAL ASSETS	983,302	2,073,450	4,523,169	3,520,862	2,413,405	4,482,183	6,819,292	5,067,567	4,330,338	3,095,473	5,093,585	3,509,321	(550,663)	45,361,284
LIABILITIES														
9) BONDS & NOTES PAYABLE	822,416	1,714,224	4,009,893	3,243,578	2,277,344	4,171,905	6,398,792	4,725,626	3,970,863	2,728,556	4,652,475	3,192,541	0	41,908,213
10)ACC'D INT. PAYABLE	21,898	50,231	99,939	108,979	68,354	105,952	171,228	124,811	119,079	59,442	112,885	90,351	0	1,133,149
11)OTHER LIABILITIES	33,681	85,767	136,464	11,152	13,140	28,065	67,880	23,635	25,061	91,576	89,686	121,907	(550,663)	177,351
12)TOTAL LIABILITIES	877,995	,1,850,222	4,246,296	3,363,709	2,358,838	4,305,922	6,637,900	4,874,072	4,115,003	2,879,574	4,855,046	3,404,799	(550,663)	43,218,713
CAPITAL & SURPLUS														
13)STOCK & CERTIFICATES	50,824	100,304	232,384	192,892	111,237	221,933	328,030	232,930	227,035	137,297	238,339	167,741	0	2,240,946
14)SURPLUS	54,483	122,924	44,489	(35,739)	(56,670)	(45,672)	(146,638)	(39,435)	(11,700)	78,602	200	(63,219)	0	(98,375)
15)TOTAL CAPITAL	105,307	223,228	276,873	157,153	54,567	176,261	181,392	193,495	215,335	215,899	238,539	104,522	0	2,142,571
16)TOTAL LIAB. & CAPITAL	983,302	2,073,450	4,523,169	3,520,862	2,413,405	4,482,183	6,819,292	5,067,567	4,330,338	3,095,473	5,093,585	3,509,321	(550,663)	45,361,284
17)FARM CREDIT CAPITAL CORP. STOCK									10,000					10,000
18)RAP ADJUST. TO SURPLUS				35,739	56,670	45,672	146,638	39,435	1,800			63,219		389,173

FARM CREDIT SYSTEM
FEDERAL LAND BANKS/FEDERAL LAND BANK ASSOCIATIONS
COMBINED STATEMENT OF INCOME
FOR THE YEAR ENDING DECEMBER 31, 1986
($000)

	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS	ST. PAUL	OMAHA	WICHITA	TEXAS	SACRAMENTO	SPOKANE	ELIMINATIONS	COMBINED
1) TOTAL INT. INCOME	106,196	229,866	516,797	414,639	243,733	462,014	664,409	522,242	477,918	303,777	499,421	357,439	(34)	4,798,417
2) INTEREST EXPENSE	86,566	196,318	478,688	417,911	272,104	444,086	677,436	525,323	462,376	258,944	467,307	352,638	(34)	4,639,663
3) NET INT INCOME	19,630	33,548	38,109	(3,272)	(28,371)	17,928	(13,027)	(3,081)	15,542	44,833	32,114	4,801	0	158,754
4) PROV. FOR LOAN LOSSES	(1,559)	933	144,340	189,269	152,425	105,838	334,619	221,901	187,535	18,394	28,847	113,522	0	1,496,064
5) NET INT. INC. AFTER PROVISION	21,189	32,615	(106,231)	(192,541)	(180,796)	(87,910)	(347,646)	(224,982)	(171,993)	26,439	3,267	(108,721)	0	(1,337,310)
6) OTHER INCOME	912	7,530	9,931	2,985	6,206	3,353	8,603	4,328	4,914	5,447	7,193	2,246	0	63,648
7) OTHER EXPENSE	49,423	100,916	193,985	(112,889)	(67,571)	32,668	(3,285)	(181,219)	(155,379)	125,616	162,734	169,631	0	314,630
8) NET INCOME	(27,322)	(60,771)	(290,285)	(76,667)	(107,019)	(117,225)	(335,758)	(39,435)	(11,700)	(93,730)	(152,274)	(276,106)	0	(1,588,292)
9) RAP ADJUSTMENT	0	0	0	35,739	56,670	45,672	146,638	39,435	1,800	0	0	63,219	0	389,173
10) RAP ADJ. NET INCOME	(27,322)	(60,771)	(290,285)	(40,928)	(50,349)	(71,553)	(189,120)	0	(9,900)	(93,730)	(152,274)	(212,887)	0	(1,199,119)

FARM CREDIT SYSTEM
FEDERAL INTERMEDIATE CREDIT BANKS/PRODUCTION CREDIT ASSOCIATIONS
COMBINED STATEMENT OF CONDITION
DECEMBER 31, 1986
($000)

ASSETS	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS	ST. PAUL	OMAHA	WICHITA	TEXAS	SACRAMENTO	SPOKANE	ELIMINATIONS	COMBINED
1) LOANS	571,284	745,695	1,014,922	919,400	536,067	656,412	2,047,114	630,273	666,993	1,010,494	2,211,108	552,936	0	11,562,698
2) ALLOWANCE FOR LOSSES	22,111	26,692	76,549	38,110	27,262	35,410	189,529	77,400	83,938	59,342	84,466	60,211	0	781,020
3) NET LOANS	549,173	719,003	938,373	881,290	508,805	621,002	1,857,585	552,873	583,055	951,152	2,126,642	492,725	0	10,781,678
4) CASH,INVEST.& NOTE REC.	126,830	165,225	280,778	175,397	111,758	243,968	589,011	212,419	79,639	765,731	685,132	156,685	(11,989)	3,580,584
5) TOTAL EARN. ASSETS	676,003	884,228	1,219,151	1,056,687	620,563	864,970	2,446,596	765,292	662,694	1,716,883	2,811,774	649,410	(11,989)	14,362,262
6) OTHER PROPERTY OWNED	1,038	2,830	14,027	12,655	11,770	8,334	38,769	11,097	6,986	21,898	43,626	10,877	0	183,907
7) OTHER ASSETS	16,983	25,138	59,150	83,134	32,041	54,774	125,639	56,676	49,571	58,051	106,670	17,909	(312)	685,424
8) TOTAL ASSETS	694,024	912,196	1,292,328	1,152,476	664,374	928,078	2,611,004	833,065	719,251	1,796,832	2,962,070	678,196	(12,301)	15,231,593
LIABILITIES														
9) BONDS & NOTES PAYABLE	556,806	733,070	979,324	820,484	501,469	653,353	2,252,398	677,746	517,826	1,516,357	2,562,560	548,400	0	12,319,793
10)ACC'D INT. PAYABLE	8,334	11,345	14,741	21,973	7,803	10,182	37,920	13,623	9,348	13,820	36,324	8,958	0	194,371
11)OTHER LIABILITIES	18,549	14,123	21,849	20,151	27,203	31,999	35,720	27,364	17,788	20,974	42,407	31,799	(12,301)	297,625
12)TOTAL LIABILITIES	583,689	758,538	1,015,914	862,608	536,475	695,534	2,326,038	718,733	544,962	1,551,151	2,641,291	589,157	(12,301)	12,811,789
CAPITAL & SURPLUS														
13)STOCK & CERTIFICATES	50,247	56,858	119,449	92,410	65,517	74,597	205,572	59,750	61,313	106,581	221,957	61,567	0	1,175,818
14)SURPLUS	60,088	96,800	156,965	197,458	62,382	157,947	79,394	54,582	112,976	139,100	98,822	27,472	0	1,243,986
15)TOTAL CAPITAL	110,335	153,658	276,414	289,868	127,899	232,544	284,966	114,332	174,289	245,681	320,779	89,039	0	2,419,804
16)TOTAL LIAB. & CAPITAL	694,024	912,196	1,292,328	1,152,476	664,374	928,078	2,611,004	833,065	719,251	1,796,832	2,962,070	678,196	(12,301)	15,231,593
17)RAP ADJUST. TO SURPLUS (PCA)							7,055							

FARM CREDIT SYSTEM
FEDERAL INTERMEDIATE CREDIT BANKS/PRODUCTION CREDIT ASSOCIATIONS
COMBINED STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 1986
($000)

	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS	ST. PAUL	OMAHA	WICHITA	TEXAS	SACRAMENTO	SPOKANE	ELIMINATIONS	COMBINED
1) TOTAL INT. INCOME	64,080	83,348	139,149	124,661	65,314	92,138	279,198	89,134	84,155	139,199	281,633	76,953	(90)	1,518,872
2) INTEREST EXPENSE	43,348	56,551	93,155	78,423	43,454	56,084	196,565	69,816	54,672	97,258	200,309	52,230	(116)	1,041,749
3) NET INT INCOME	20,732	26,797	45,994	46,238	21,860	36,054	82,633	19,318	29,483	41,941	81,324	24,723	26	477,123
4) PROV. FOR LOAN LOSSES	572	1,756	43,547	15,738	4,608	297	93,602	16,673	17,647	15,403	63,929	14,319	0	288,091
5) NET INT. INC. AFTER PROVISION	20,160	25,041	2,447	30,500	17,252	35,757	(10,969)	2,645	11,836	26,538	17,395	10,404	26	189,032
6) OTHER INCOME	3,383	1,386	6,354	4,254	2,853	3,049	12,851	3,079	1,556	3,160	2,031	1,001	0	46,557
7) OTHER EXPENSE	28,403	27,295	48,271	59,666	19,766	46,402	102,160	47,124	36,160	39,544	79,875	29,949	26	564,641
8) NET INCOME	(4,860)	(868)	(39,470)	(24,912)	339	(7,596)	(100,278)	(40,600)	(22,768)	(9,846)	(60,449)	(17,744)	0	(329,052)
9) RAP ADJUSTMENT	0	0	0	0	0	0	7,055	0	0	0	0	0	0	7,055
10)RAP ADJ. NET INCOME (PCA)	(4,860)	(868)	(39,470)	(24,912)	339	(7,596)	(93,223)	(40,600)	(22,768)	(9,846)	(60,449)	(17,744)	0	(321,997)

BANK FOR COOPERATIVES
STATEMENT OF CONDITION
DECEMBER 31, 1986
($000)

ASSETS	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS	ST. PAUL	OMAHA	WICHITA	TEXAS	SACRAMENTO	SPOKANE	CBC	ELIMINATIONS	COMBINED BC SYSTEM
1) LOANS	131,096	56,843	264,429	335,517	337,326	269,017	854,648	264,619	370,169	136,932	535,677	227,632	3,624,699	(8,407)	7,400,197
2) ALLOWANCE FOR LOSSES	2,127	1,591	9,613	8,375	3,074	9,767	20,367	9,333	7,372	2,486	18,763	5,307	47,349	0	145,524
3) NET LOANS	128,969	55,252	254,816	327,142	334,252	259,250	834,281	255,286	362,797	134,446	516,914	222,325	3,577,350	(8,407)	7,254,673
4) CASH, INVEST. & NOTES REC.	48,932	36,556	80,447	83,203	123,208	115,197	309,875	121,169	123,203	83,234	47,228	80,150	1,457,157	(397,230)	2,312,409
5) TOTAL EARNING ASSETS	177,901	91,808	335,263	410,425	457,460	374,447	1,144,156	376,455	486,000	217,680	564,142	302,475	5,034,507	(405,637)	9,567,082
6) OTHER PROPERTY OWNED	135	60	168	257	302	429	1,610	385	658	2,168	288	639	0	0	7,099
7) OTHER ASSETS	7,650	2,166	14,548	1,541	14,900	11,131	26,499	10,660	14,195	14,241	16,231	15,964	98,498	(12,068)	236,156
8) TOTAL ASSETS	185,686	94,034	349,979	412,223	472,662	386,007	1,172,265	387,500	500,853	234,089	580,661	319,078	5,133,005	(417,705)	9,810,337
LIABILITIES															
9) BONDS & NOTES PAYABLE	129,778	67,999	269,932	311,087	362,405	293,158	920,854	293,913	354,220	191,454	469,386	254,960	4,751,072	(98,481)	8,571,737
10) ACC'D. INT. PAYABLE	1,347	3,112	6,205	7,099	5,400	5,824	14,084	7,974	5,562	1,083	4,765	4,747	39,673	(1)	106,874
11) OTHER LIABILITIES	9,249	3,475	7,693	1,145	780	4,152	5,530	701	1,980	173	20,926	6,961	2,762	(9,072)	56,449
12) TOTAL LIABILITIES	140,374	74,586	283,830	319,331	368,585	303,134	940,468	302,588	361,762	192,710	495,071	266,668	4,793,507	(107,554)	8,735,060
CAPITAL & SURPLUS															
13) STOCK & CERTIFICATES	32,952	14,094	47,795	65,906	81,902	59,552	170,961	69,728	105,396	24,566	66,763	40,705	258,756	(267,780)	771,296
14) SURPLUS	12,360	5,354	18,354	26,986	22,175	23,321	60,836	15,184	33,695	16,813	18,827	11,705	80,742	(42,371)	303,981
15) TOTAL CAPITAL	45,312	19,448	66,149	92,892	104,077	82,873	231,797	84,912	139,091	41,379	85,590	52,410	339,498	(310,151)	1,075,277
16) TOTAL LIAB. & CAPITAL	185,686	94,034	349,979	412,223	472,662	386,007	1,172,265	387,500	500,853	234,089	580,661	319,078	5,133,005	(417,705)	9,810,337

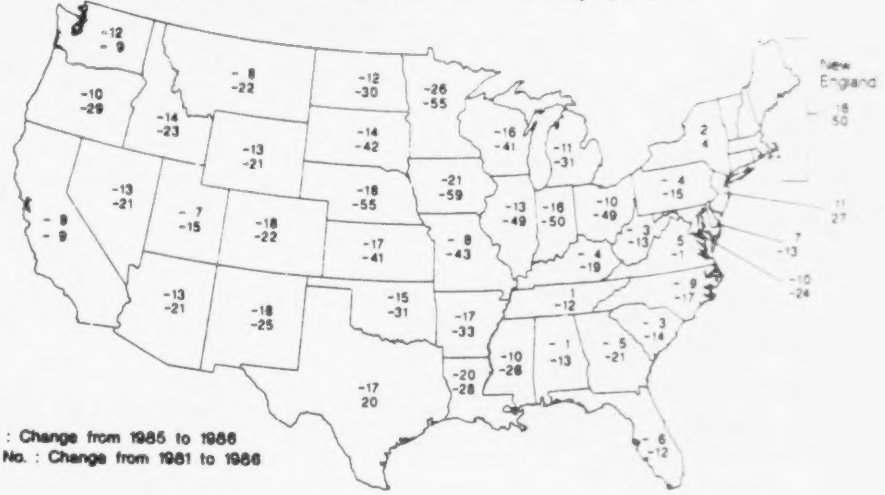
BANK FOR COOPERATIVES
STATEMENT OF INCOME
FOR THE YEAR ENDED
DECEMBER 31, 1986
($000)

	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS	ST. PAUL	OMAHA	WICHITA	TEXAS	SACRAMENTO	SPOKANE	CBC	ELIMINATIONS	COMBINED BC SYSTEM
1) TOTAL INTEREST INCOME	14,543	6,290	28,815	45,882	31,038	36,286	108,774	44,063	42,026	17,674	43,332	30,566	422,595	(5,935)	865,949
2) TOTAL INTEREST EXPENSE	10,392	5,128	24,270	39,155	25,142	28,325	86,197	36,032	28,821	13,306	34,971	26,333	372,110	(5,977)	724,205
3) NET INTEREST INCOME	4,151	1,162	4,545	6,727	5,896	7,961	22,577	8,031	13,205	4,368	8,361	4,233	50,485	42	141,744
4) PROVISION FOR LOAN LOSSES	0	(190)	(491)	600	454	0	929	2,847	3,745	203	2,615	237	2,613	0	13,562
5) NET INT. INC. AFTER PROVISION	4,151	1,352	5,036	6,127	5,442	7,961	21,648	5,184	9,460	4,165	5,746	3,996	47,872	42	128,182
6) OTHER INCOME	2,285	1,315	6,656	6,114	7,018	1,332	8,369	1,851	2,999	852	3,940	1,308	12,717	(37,741)	19,015
7) OTHER EXPENSE	6,942	2,939	8,437	11,698	12,919	9,041	24,659	9,643	11,649	5,624	12,777	7,421	22,446	(43)	146,152
8) NET INCOME	(506)	(272)	3,255	543	(459)	252	5,358	(2,608)	810	(607)	(3,091)	(2,117)	38,143	(37,656)	1,045

Attachment C

Percent Change in Average Value of Farm Real Estate Per Acre

April 1, 1985 - February 1, 1986 and February 1, 1981 - February 1, 1986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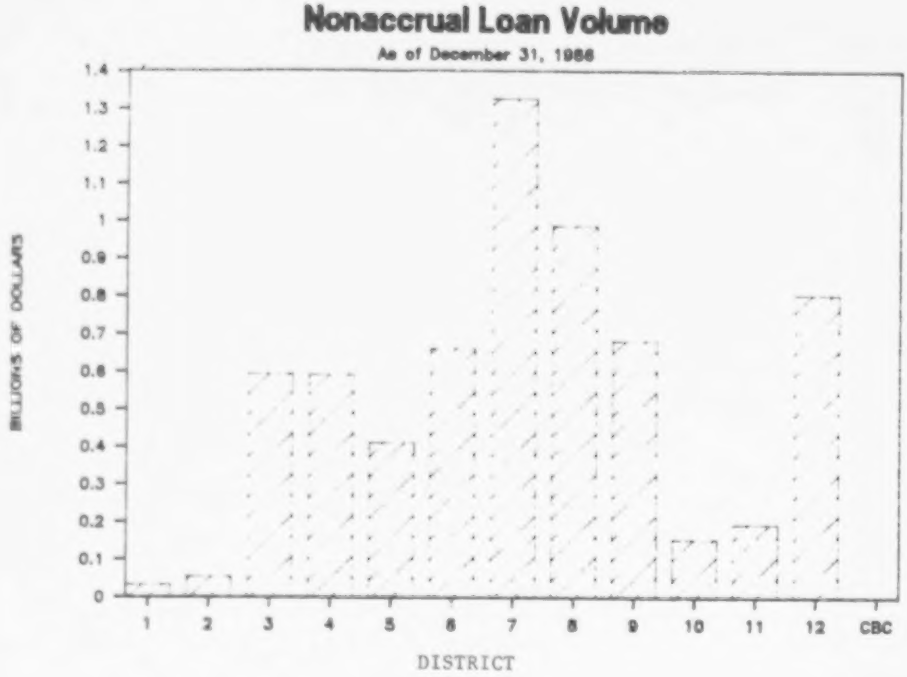
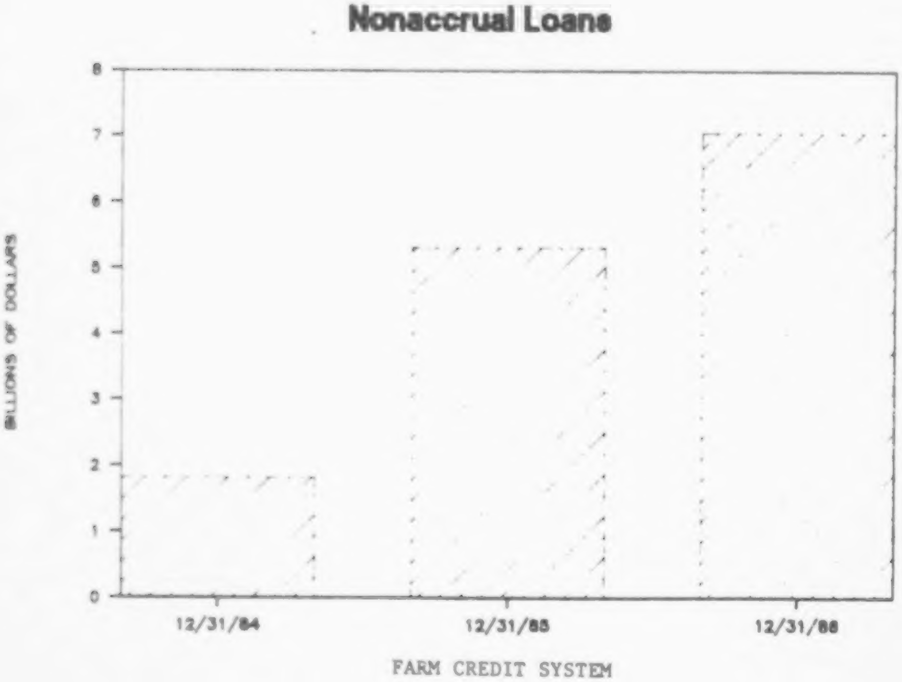
Top No. : Change from 1985 to 1986
Bottom No. : Change from 1981 to 1986

Based on index of average value per acre (1977=100)

Source: USDA Agricultural Resources Publication, June 1986.

Attachment D
Page 1

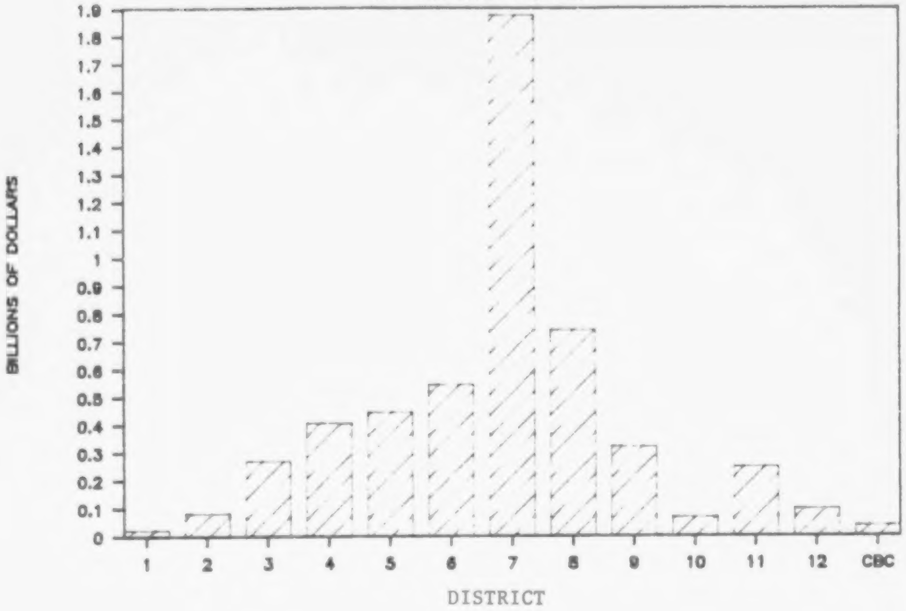




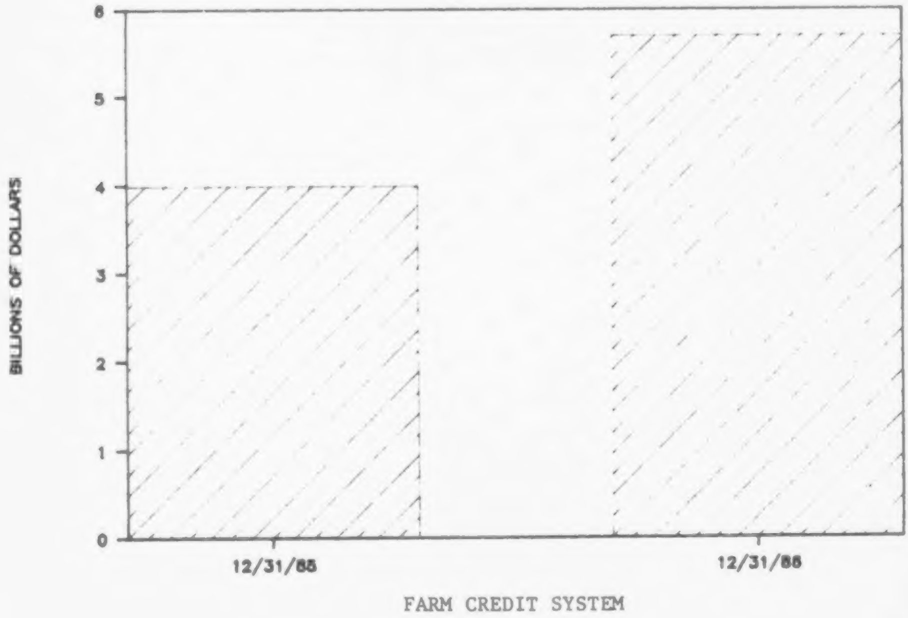
Attachment D
Page 2

Other High Risk Loans

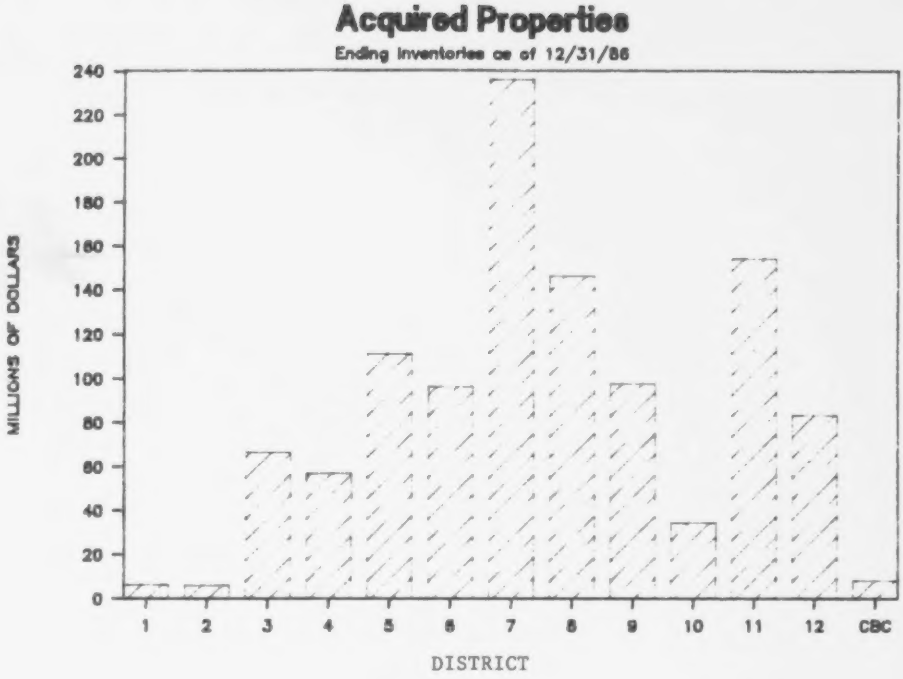
As of December 31, 1986

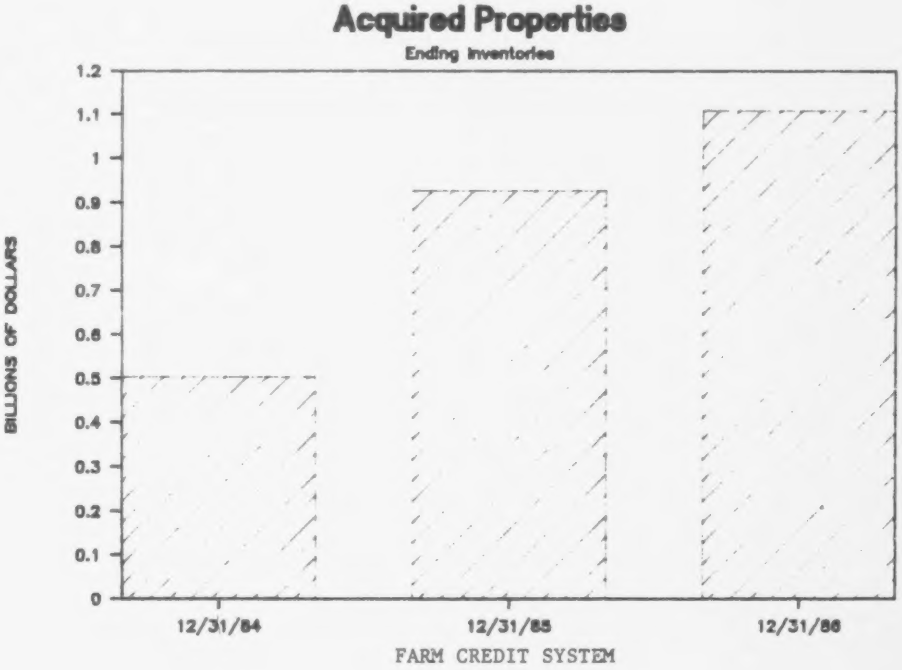


Other High Risk Loans



Attachment D
Page 3





Attachment D
Page 4

NATIONAL CREDIT AND REVIEW STANDARDS MONITORING REPORT
ACQUIRED PROPERTY
As of DECEMBER 31, 1986

	Springfield		Baltimore		Columbia		Louisville		Jackson		St.Louis		St.Paul		Omaha		Wichita		Texas		Sacramento		Spokane		C B C		System Totals	
	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount	no.	amount
FLB/FLBAs																												
New acquisitions-	36	5,502	42	3,791	364	65,592	313	46,422	263	52,937	371	72,601			1,013	146,666	916	181,527	88	12,618	198	127,481	172	19,108			3,776	734,245
Sales-	70	3,660	55	4,717	732	65,467	432	39,478	374	48,648	364	50,539			352	61,528	1,083	113,395	29	4,996	246	62,089	65	15,124			3,802	470,361
Ending inventory-	33	5,499	41	3,352	297	52,713	336	44,357	447	99,537	646	88,161	1,790	195,956	1,073	135,623	746	90,590	78	10,791	184	111,066	224	72,509			5,895	910,194
Time in inventory:																												
0-3 months-	1	100	8	565	63	15,262	20	1,956	43	6,322	52	9,562	318	37,892	232	31,682	139	13,606	30	3,716	28	14,227	44	10,160			978	145,030
4-6 months-	8	1,031	6	449	54	10,367	69	14,187	53	11,569	110	20,319	384	50,587	230	30,113	153	18,951	22	3,509	39	17,099	25	4,781			1,153	182,962
7-9 months-	9	2,797	7	359	57	16,103	54	8,076	83	19,742	84	15,538	343	48,485	227	34,458	132	19,677	9	1,065	29	9,314	47	57,623			1,101	233,237
10-12 months-	3	143	3	59	27	6,810	24	4,317	32	6,513	65	11,952	176	25,093	191	14,835	88	15,649	6	623	20	35,392	24	5,961			659	127,347
13-18 months-	5	327	9	1,396	33	6,140	30	7,100	82	39,746	129	23,905	267	47,106	141	27,102	116	22,299	6	1,161	88	14,612	32	12,696			910	202,630
19-24 months-	7	1,233	8	434	31	4,391	48	8,900	81	45,812	116	21,514	176	32,243	98	27,240	66	15,255	5	1,523	19	14,163	25	5,925			680	178,713
FICB/PCAs																												
New acquisitions-	9	668	17	1,347	158	10,297	195	11,377	64	10,196	41	3,453					91	11,715	83	14,300	26	6,767					684	70,528
Sales-	16	1,027	13	1,169	395	23,482	164	13,270	71	4,718	50	3,550					55	3,300	38	4,434	2	612					804	55,562
Ending inventory-	17	1,038	20	2,830	137	14,027	181	12,635	70	11,770	117	8,334	308	38,769	107	11,097	62	6,986	127	21,090	133	42,866	87	10,877			1,366	183,147
Time in inventory:																												
0-3 months-	2	108	3	767	41	5,096	9	887	8	522	18	1,447	40	4,279			19	4,877	16	2,055	17	5,308					173	25,346
4-6 months-	0	0	1	14	20	1,344	27	1,540	32	6,958	17	575	49	6,601			7	1,100	38	4,650							191	22,782
7-9 months-	2	93	5	539	10	3,132	20	1,763	8	2,100	6	487	77	12,161			13	2,663	6	786	2	1,459					149	25,097
10-12 months-	0	0	3	808	6	623	11	1,453	4	396	10	565	40	5,003			7	393	5	2,438							86	12,079
13-18 months-	5	537	3	473	21	3,069	23	2,209	9	580	21	5,662	53	6,748			5	581	5	1,210	6	4,542					151	25,551
19-24 months-	8	102	5	478	15	3,419	25	3,995	9	3,485	16	2,305	66	12,844			16	978	37	8,629							197	36,147
OCs																												
New acquisitions-	0	0	0	0	0	0	0	0	0	0	0	0	1	40	0	0	2	150	2	385	0	0	2	349	2	8,185	9	9,029
Sales-	0	0	0	0	0	0	0	0	0	0	0	0	0	0	2	1,362	5	70	31	2,453	0	0	1	186	0	0	39	[illegible]
Ending inventory-	0	135	0	60	0	168	2	257	0	302	5	429	6	1,610	1	385	13	658	6	2,160	0	0	2	639	2	8,407	37	15,210
Time in inventory:																												
0-3 months-	0	0	0	0	0	0	0	0	0	0	0	0	1	40	0	0	0	0	0	0	0	0	0	0	0	0	1	40
4-6 months-	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	113	1	131	0	0	0	0	0	0	2	244
7-9 months-	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	2,759	1	2,759
10-12 months-	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	77	0	0	0	0	1	5,426	2	5,503
13-18 months-	0	0	0	0	0	0	0	0	0	0	0	0	2	724	0	0	0	0	2	1,685	0	0	0	0	0	0	4	2,409
19-24 months-	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	11	753	2	1,701	0	0	2	722	0	0	15	3,176
District Totals	50	6,672	61	6,282	434	66,908	519	57,269	517	111,609	768	96,924	2,104	236,335	1,181	147,105	821	98,234	211	34,057	317	153,932	313	84,065	2	8,407	7,298	1,108,559

Legend:
Blank space - not reported
All amounts rounded to nearest thousand

Footnotes:
Ending inventory amounts agree with Systemwide financial information. The figures do not necessarily correspond to aging inventory totals due to differences in reporting.

Attachment E

RUNOFF OF HIGH COST OF DEBT

Year	Average Principal -thousands-	Average Existing Rate -percent-	Average Rate* -percent-	Excess Interest Cost -thousands-
1985	$63,992,317	11.31	6.97	$2,778,623
1986	53,639,610	10.52	6.57	2,118,898
1987	36,392,660	10.62	6.77	1,400,855
1988	24,477,763	11.18	7.03	1,015,977
1989	17,937,592	11.18	7.17	720,325
1990	11,863,026	11.21	7.26	468,620
1991	7,739,973	11.42	7.32	317,331
1992	4,598,023	11.11	7.32	174,478
1993	3,589,519	11.03	7.32	133,124
1994	2,483,176	10.38	7.32	75,966
1995	1,551,811	9.62	7.32	35,720
1996	1,465,011	9.72	7.32	35,187
1997	671,775	11.71	7.32	29,505
1998	305,838	11.88	7.32	13,937
1999	305,838	11.88	7.32	13,937
2000	305,838	11.88	7.32	13,937
2001	269,400	11.60	7.32	11,540
2002	205,838	10.89	7.32	7,357
2003	176,797	10.38	7.32	5,403
2004	122,711	9.31	7.32	2,439
2005	117,700	9.27	7.32	2,295
2006	108,947	9.30	7.32	2,152
2007	24,859	8.76	7.32	359

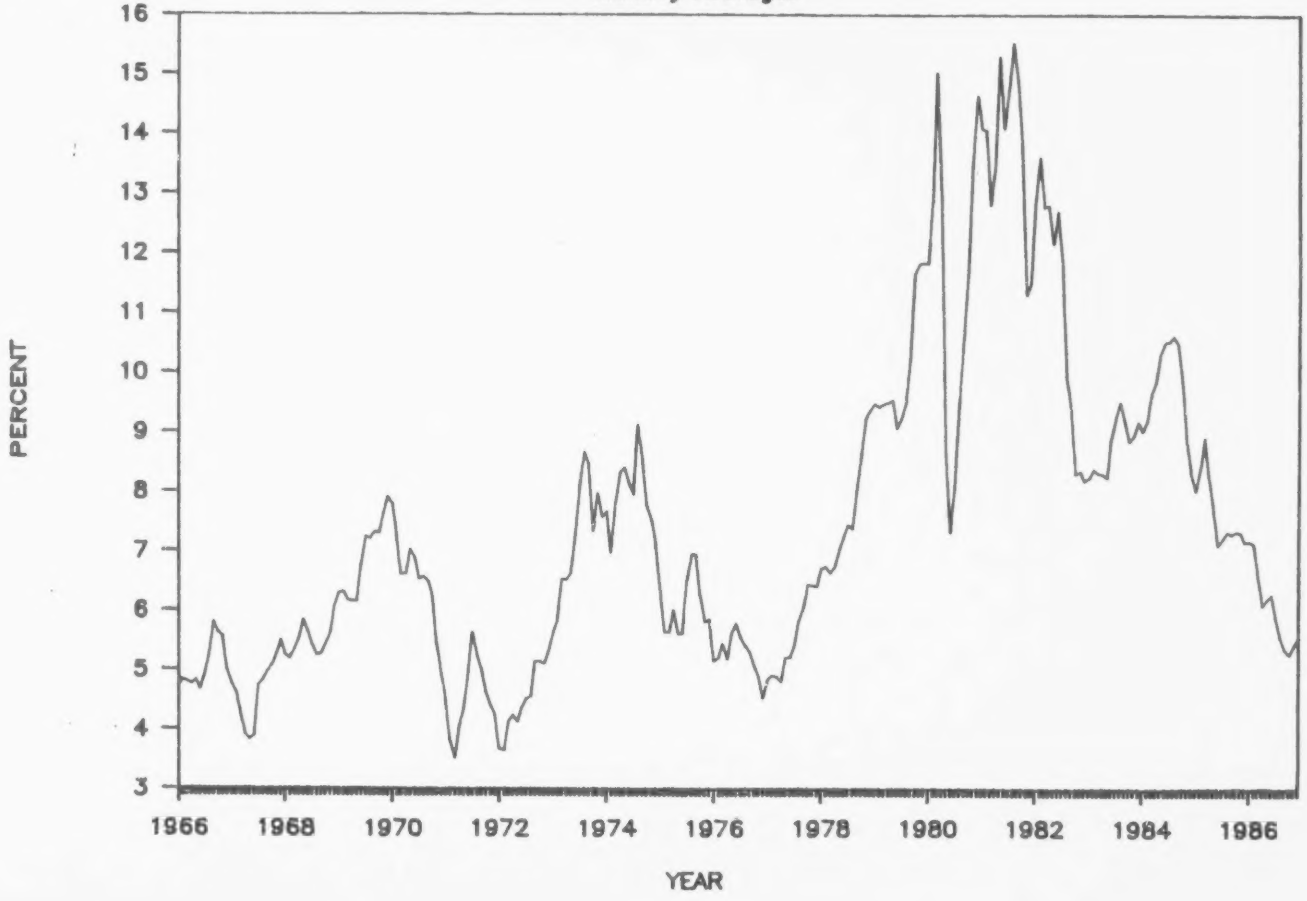
*1985 and 1986 actual rates, 1987 and beyond based on current projections

R050/MW1
2/24/87

Attachment F

Six-Month U.S. Treasuries

Monthly Averages



Attachment G
Page 1

SYSTEM BANK AND SERVICE ENTITY PRESIDENTS
February 1987

Present Position	Name	Date Assumed Current Position	Previous Position
1. President - Springfield FCBs	Howell Hughes*	8/1/75	Executive VP - Springfield FCBs
2. President - Baltimore FCBs	Gene L. Swackhamer	1977	Deputy Governor - Office of Finance & Research for FCA
3. CEO - Columbia FCBs	Maxey D. Love, Jr.	8/85	President - Columbia BC
4. President & CEO - Louisville FCBs	Steven J. Montgomery	3/31/86	Acting President - Louisville FCBs
5. President & CEO - Jackson FCBs	James L. Toft	1/86	President - Jackson BC
6. CEO - St. Louis FCBs	C. T. (Terry) Fredrickson	1/1/86	President - FLB/FICB of St. Louis
7. President & CEO - St. Paul FCS	Larry D. Buegler	9/8/86	Chairman & CEO - Norwest Bank of St. Paul
8. President & CEO - Omaha FCBs	James Kirk	1/1/87	Senior VP - Wells Fargo
9. President - Wichita FCBs	Vernon Peckham	11/86	VP & Director of Finance - Hahnco Co. - Arizona
10. CEO - Texas FCBs	James A. Rogers*	4/86	President - Texas FCBs
11. President - Sacramento FCBs	George W. Hickman	7/1/86	Executive VP & - COO - Sacramento BC
12. President & CEO - Spokane FCBs	Kenneth P. Krueger	1/5/85	President - Spokane FLB
13. President - Central Bank	W. M. Harding	1/31/77	Governor - FCA

R050/MV1
2/24/87

Attachment G
Page 2

Present Position	Name	Date Assumed Current Position	Previous Position
14. President - Farm Credit Council	John A. Waits	10/3/86	VP - Legislation - Farm Credit Council
15. President & CEO - Funding Corporation	Alan D. Fass	8/15/86	Vice President - Funding Corporation
16. President & CEO - Leasing Services Corporation	Rolf E. Haugen	3/2/84	Group VP & CFO - Land O'Lakes
17. President & CEO - Capital Corporation	Hugh R. Macklin	8/1/86	President - H.R. Macklin & Sons - California
18. President & CEO - Farm Credit Corporation of America	H. Brent Beesley	2/13/86	President & CEO - Charter Savings Corporation

*Have announced retirement within next 30 days.

R050/MV2
2/24/87

Attachment H
Page 1

FARM CREDIT SYSTEM INTEREST RATES

February 23, 1987

FARM CREDIT BANKS OF SPRINGFIELD

	Tiers	February, 1987 Rates
FLB		
30-Day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	9.75
	II	10.75
	III	11.75
Fixed Rate		
5 Years	Tiers	
	I	8.75
	II	9.75
Rural Housing		10.75 - 12.25
PCA		
30-day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	7.60*
	II	
	III	12.10
Fixed Rate (variable)		N/A

* Rates range from a low of 7.60 to a high of 12.10.

	Tiers	February, 1987 Rates
BC		
Seasonal Rate	Tiers	
	I	7.00
	II	7.75
	III	8.50
Term Rate	Tiers	
	I	8.75.
	II	9.50
	III	10.25

R850/AA1
2/23/87

Attachment H
Page 2

FARM CREDIT SYSTEM INTEREST RATES
February 23, 1987

FARM CREDIT BANKS OF BALTIMORE

		February, 1987 Rates
FLB		
30-Day Variable Rate		9.50
Differential Rate (variable)		N/A
Fixed Rate	Tiers	
3 Years	I	8.75
	II	9.25
	III	9.75
5 Years	I	9.00
	II	9.50
	III	10.00
10 Years	I	9.75
	II	10.25
	III	10.75
15 Years	I	10.00
	II	10.50
	III	11.00
PCA		
30-day Variable Rate		8.25
Differential Rate (variable)		N/A
Fixed Rate		
5 - 89 Days		7.00
90 - 179 Days		7.10
180 - 269 Days		7.15
270 - 365 Days		7.25

R850/AA2
2/23/87

Attachment H
Page 3

BALTIMORE

PCA - Continued

3 Years	7.45
5 Years	7.70
7 Years	8.00
10 Years	8.30

BC

Seasonal Rate	7.50
Term Rate	9.50

FARM CREDIT SYSTEM INTEREST RATES

February 23, 1987

FARM CREDIT BANKS OF COLUMBIA

		February, 1987 Rates
FLB		
30-Day Variable Rate		11.75
Differential Rate (variable)		N/A
Fixed Rate	Tiers	
1 Year	I	9.50
	II	10.50
	III	11.50
3 Years	I	10.00
	II	11.00
	III	12.00
5 Years	I	10.25
	II	11.25
	III	12.25
10 Years	I	10.75
	II	11.75
	III	12.75
15 Years	I	11.00
	II	12.00
	III	13.00
PCA		
30-day Variable Rate		N/A
Differential Rate	Tiers	
Operating Loans (variable)	I	7.50
	II	9.25
	III	11.25
Operating Loans (Fixed)	I	8.75 - 8.95
	II	10.50 - 10.70
	III	12.50 - 12.70

COLUMBIA

PCA - Continued

Intermediate Term Loans (variable)	I	8.50
	II	10.25
	III	12.25
Intermediate Term Loans (fixed)		
1 Year	I	8.95
	II	10.70
	III	12.70
3 Years	I	9.35
	II	11.10
	III	13.10
5 Years	I	9.75
	II	11.50
	III	13.50

BC

Seasonal Rate (variable)	8.00
Term Rate (variable)	10.00

FARM CREDIT SYSTEM INTEREST RATES
February 23, 1987

FARM CREDIT BANKS OF LOUISVILLE

		February, 1987 Rates
FLB		
30-Day Variable Rate		12.75
Differential Rate (variable)		N/A
Fixed Adjustable Rate		
	Tiers	
1 Year	I	9.50
	II	10.15
	III	10.50
	IV	12.15
	V	12.75
3 Years	I	9.70
	II	10.35
	III	10.70
	IV	12.35
	V	12.95
5 Years	I	9.85
	II	10.50
	III	10.85
	IV	12.50
	V	13.10
PCA		
30-day Variable Rate		9.90
Differential Rate (variable)	Tiers	
	I	8.90
	II	9.90
	III	10.90
Fixed Rate (variable)		N/A

R850/AA6
2/23/87

Attachment H
Page 7

LOUISVILLE

BC

Seasonal Loans	
Variable Rates	7.50 - 8.25
Fixed Rates	7.40 - 8.15
Term Loans	
Variable Rates	10.00 - 10.75
Fixed Rates	
6 Months	7.55 - 8.30
1 Year	7.70 - 8.45
4 Years	8.55 - 9.30

R850/AA7
2/23/87

Attachment H
Page 8

FARM CREDIT SYSTEM INTEREST RATES
February 23, 1987

FARM CREDIT BANKS OF JACKSON

		February, 1987 Rates
FLB		
30-Day Variable Rate	Ag Loans	12.25
	Rural Home	12.50
Differential Rate (variable)		N/A
Fixed Rate		
1 Year		8.95
3 Year		9.50
5 Year		9.80
PCA		
30-day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	10.30
	II	10.80
	III	11.80
	IV	12.60
Fixed Rate - Preferred Customers		
1 Month		8.55
6 Months		8.60
9 Months		8.70
1 Year		8.75
2 Years		9.05
5 Years		9.65
7 Years		10.05
10 Years		10.15

R850/AA8
2/23/87

Attachment H
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JACKSON

BC

Seasonal Rate (variable)	9.00
Term Rate (variable)	9.00
Seasonal Fixed	7.85 - 8.10
Term Fixed	Negotiated duration match portfolio bonds + 175 basis points
Bankers Acceptance	7.50 - 7.70

R850/AA9
2/23/87

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FARM CREDIT SYSTEM INTEREST RATES

February 23, 1987

FARM CREDIT BANKS OF ST. LOUIS

		February, 1987 Rates
FLB		
30-Day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	9.50
	II	11.00
	Base	12.50
Fixed Rate	Tiers	
1 Year	I	9.50
	II	11.00
3 Years	I	9.50
	II	11.00
5 Years	I	10.25
	II	11.50
10 Years	I	10.75
	II	12.00
5 Year Balloon	I	10.00
	II	11.25
PCA		
30-day Variable Rate		--
Differential Rate (variable)	Tiers	
	I	9.90
	II	11.20
	III	12.30
Variable Operating	I	8.50 - 9.90
	II	10.50 - 11.20
	II	12.30

R850/AA10
2/23/87

ST. LOUIS

PCA - Continued

Fixed Rate

	Tiers	
3 Years	I	9.50
	II	10.50
4 Years	I	9.80
	II	10.80
5 Years	I	10.00
	II	11.00
6 Years	I	10.30
	II	11.30
7 Years	I	10.50
	II	11.50
10 Years	I	11.00
	II	12.00
Variable Term	I	9.90
	II	11.20
	III	12.30

BC

Seasonal Rate (variable)		8.00
Term Rate (variable)		9.75
Seasonal Fixed	Tiers	
	I	6.30 - 6.65
	II	6.80 - 7.15
	III	7.30 - 7.65
	IV	7.80 - 8.15

Term Fixed

	Tiers	
2 Years	I	8.18
	II	8.43
	III	8.68
	IV	9.18
3 Years	I	8.35
	II	8.60
	III	8.85
	IV	9.35

ST. LOUIS

BC - Continued

5 Years	I	8.73
	II	8.98
	III	9.23
	IV	9.73
7 Years	I	9.09
	II	9.34
	III	9.59
	IV	10.09
10 Years	I	9.39
	II	9.64
	III	9.89
	IV	10.39

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FARM CREDIT SYSTEM INTEREST RATES
February 23, 1987

FARM CREDIT SERVICES OF ST. PAUL

		February, 1987 Rates
FLB		
30-Day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	9.75
	II	10.85
	III	12.00
Fixed Rate	Tiers	
2 Years	I	10.00
	II	11.25
	III	12.25
5 Years	I	10.25
	II	11.50
	III	12.50
PCA		
30-day Variable Rate		10.40
BC		
Seasonal Rate (variable)		7.75
Term Rate		10.25
Fixed Seasonal		7.75
Fixed Term		
1 - 10 Years		8.30 - 10.00

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FARM CREDIT SYSTEM INTEREST RATES
February 23, 1987

FARM CREDIT SERVICES OF OMAHA

		February, 1987 Rates
FLB		
30-Day Variable Rate		12.75
Old Differential Rate Program		12.00
Differential Rate (variable)	Tiers	
	I	9.50*
	II	10.75*
	III	11.50*
	IV	12.50*

* FLB rates are reduced by 25 basis points if the borrower also is a PCA borrower.

Fixed Rate		N/A
PCA		
30-day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	10.20
	II	10.90
	III	11.50
	IV	13.25
	V	13.90
Fixed Rate (variable)		N/A
BC		
Seasonal Rate (differential)	Tiers	
	I	8.50
	II	9.50
	III	10.60
	IV	11.10

R850/AA14
2/23/87

OMAHA

BC - Continued

Term Rate (differential)	Tiers I 10.00 II 11.00 III 12.40 IV 12.90
Fixed Term	
3 Years	150 - 175 basis points over current market bond costs
5 Years	225 - 250 basis points over current market bond costs
Fixed Seasonal	175 - 200 basis points over bond equivalent discount note costs
Bankers Acceptance	85 basis points over bond equivalent discount note costs

FICB

Discount	9.90 (estimate)

FARM CREDIT SYSTEM INTEREST RATES

February 23, 1987

FARM CREDIT SERVICES OF WICHITA

		February, 1987 Rates
FLB		
30-Day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	9.75
	II	10.75
	III (a)	11.75
	III (b)	12.00
	IV	12.50
Fixed Rate	Tiers	
1 Year	I	9.75*
	II	10.75
	III (a)	11.50
	III (b)	12.00
3 Years	I	10.00*
	II	11.00
	III	11.75
5 Years	I	10.25*
	II	11.25
	III	12.00

* Rate may be negotiated lower in exceptional circumstances.

PCA		
30-day Variable Rate		9.75 - 12.75 (range)
Differential Rate (variable)	Tiers	
	I	9.75
	II	10.25
	III	11.75

WICHITA

PCA - Continued

Fixed Rate (variable)	Tiers	
30 - 119 Days	I	8.50
	II	9.25
120 - 179 Days	I	9.50
	II	10.25
180 - 269 Days	I	9.00
	II	9.75
270 - 365 Days	I	10.00
	II	10.75

ITL	Tiers	
1 - 3 Years	I	9.00 - 10.00
	II	9.75 - 10.75
3 - 5 Years	I	9.25 - 10.25
	II	9.75 - 10.75
5 - 7 Years	I	9.50 - 10.50
	II	10.00 - 11.00
7 - 10 Years	I	10.00 - 11.50
	II	10.50 - 12.00

BC

Seasonal Rate	8.50
Term Rate	8.50

FICB

Discount	Tiers	
	I	7.75
	II	8.25
	III	9.00
	IV	9.75

R850/AA17
2/23/87

WICHITA

FICB - Continued

FICB Fixed Rate Operating	
30 - 89 Days	7.35
90 - 179 Days	7.35
180 - 209 Days	7.40
210 - 269 Days	7.50
270 - 319 Days	7.60
320 - 365 Days	7.75

FICB Fixed Rate ITL	
1 - 2 Years	8.25
2 - 3 Years	8.50
3 - 4 Years	8.75
4 - 5 Years	9.00
5 - 7 Years	9.40
7 - 10 Years	9.75

FARM CREDIT SYSTEM INTEREST RATES

February 23, 1987

FARM CREDIT BANKS OF TEXAS

		February, 1987 Rates
FLB		
30-Day Variable Rate	Ag Loans	10.75
	Rural Homes	11.25
Differential Rate (variable)		N/A
Fixed Rate		
5 Years	Tiers	
	I	9.875
	II	10.125
PCA		
30-day Variable Rate	Average	9.91
	Range	8.75 - 11.70
Differential Rate (variable)		N/A
Fixed Rate (average)	Range	7.35 - 9.95
BC		
Seasonal Rate		8.25
Term Rate		9.50
Fixed Rate (15 days - 6 months)		7.25 - 7.60 set daily
FICB		
Discount		8.25
Fixed Rate (Maximum 5 Years)		
30 Days - 1 Year		7.10 - 7.35

R850/AA19
2/23/87

FARM CREDIT SYSTEM INTEREST RATES

February 23, 1987

FARM CREDIT BANKS OF SACRAMENTO

		February, 1987 Rates
FLB		
30-Day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	9.50
	II	10.50
	III	11.00
	IV	11.50
	V	12.00
Fixed Rate		
1 Year		9.00
3 Years		9.40
5 Years		9.65
PCA		
30-day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	9.86
	II	10.24
	III	10.60
	IV	11.40
	V	12.11
Fixed Rate (variable)		
4 Weeks		9.06
1 Year		9.43
3 years		10.14
4 Years		10.25
5 Years		10.46

R850/AA20
2/23/87

SACRAMENTO

BC

Seasonal Rate	8.00
Term Rate	9.50

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FARM CREDIT SYSTEM INTEREST RATES

February 23, 1987

FARM CREDIT SERVICES OF SPOKANE

		February, 1987 Rates
FLB		
30-Day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I	10.00
	II	11.25
	III	12.25
Fixed Rate		
1 - 2 Years		9.40
2 - 3 Years		9.60
3 - 5 Years		9.90
PCA		
30-day Variable Rate		N/A
Differential Rate (variable)	Tiers	
	I*	9.05/9.35/10.00
	II*	10.50/10.60/11.05
	III*	12.05

* Tiered rates vary with size of loan.

Fixed Rate (variable)		N/A
BC		
Seasonal Rate	Tiers	
	I	8.50
	II	8.75
	III	9.50

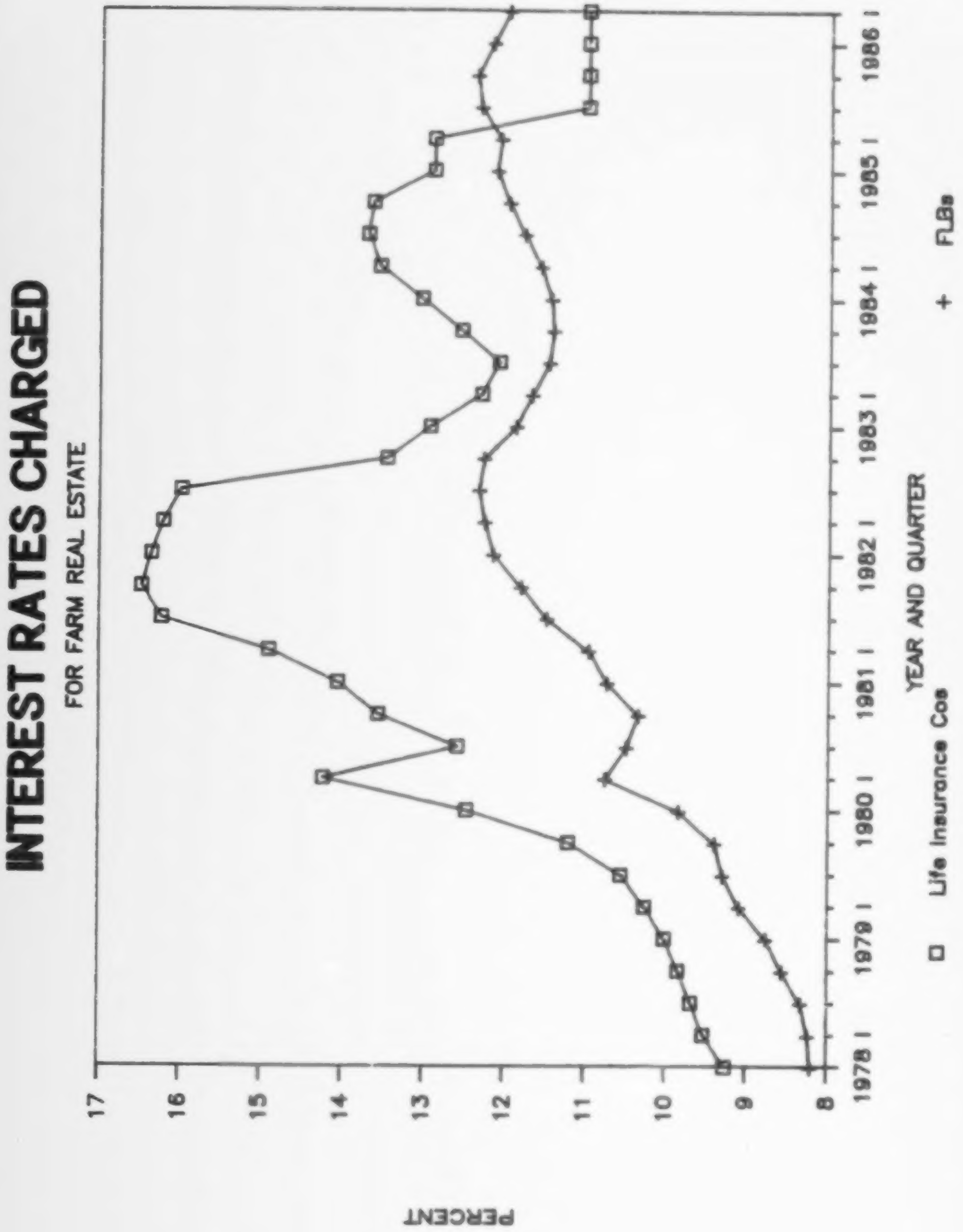
R850/AA22
2/23/87

SPOKANE

BC - Continued

Term Rate	Tiers	
	I	9.25
	II	10.00
	III	11.00

Attachment 1
Page 1



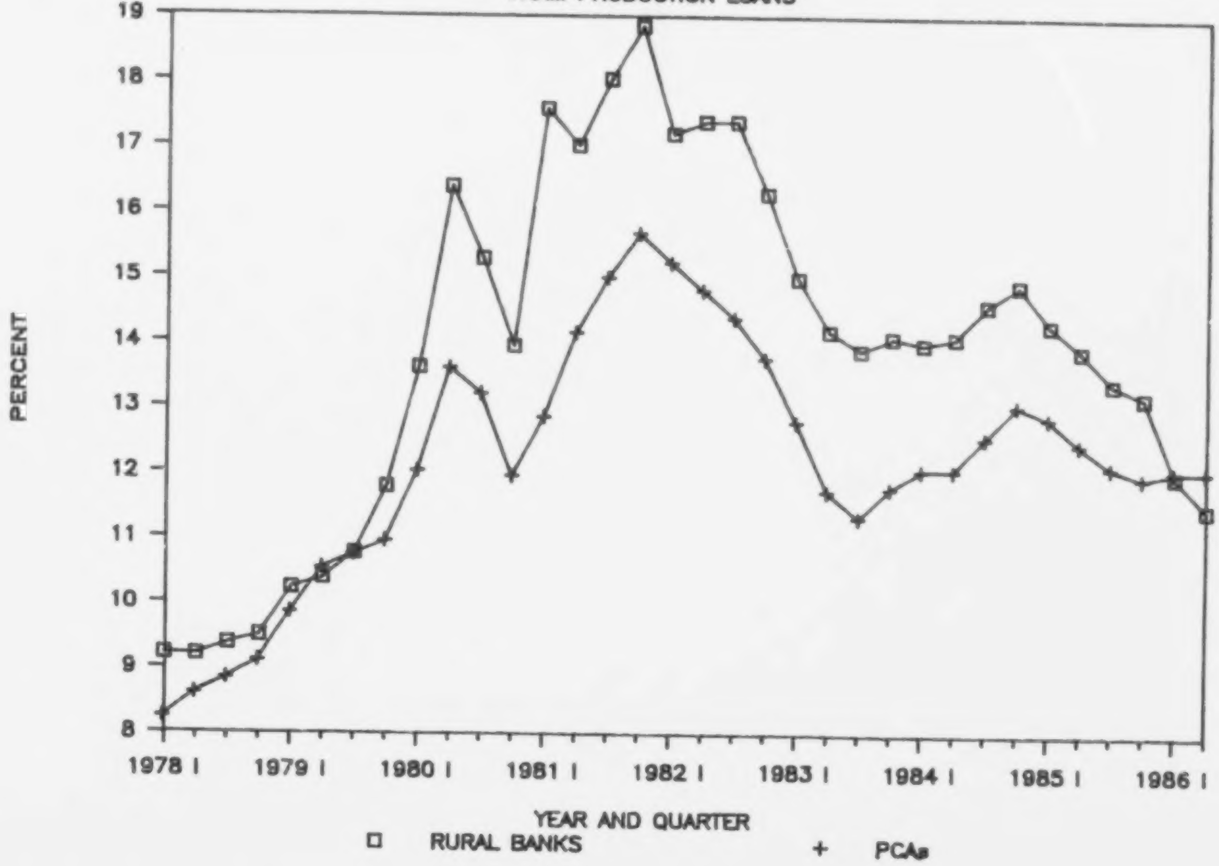
INTEREST RATES CHARGED

FOR FARM REAL ESTATE

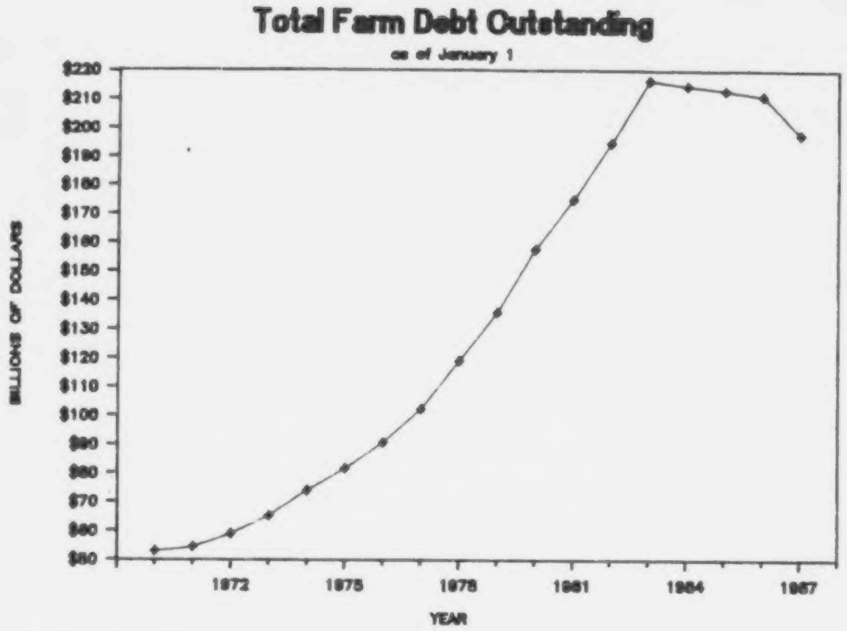
Attachment I
Page 2

INTEREST RATES CHARGED

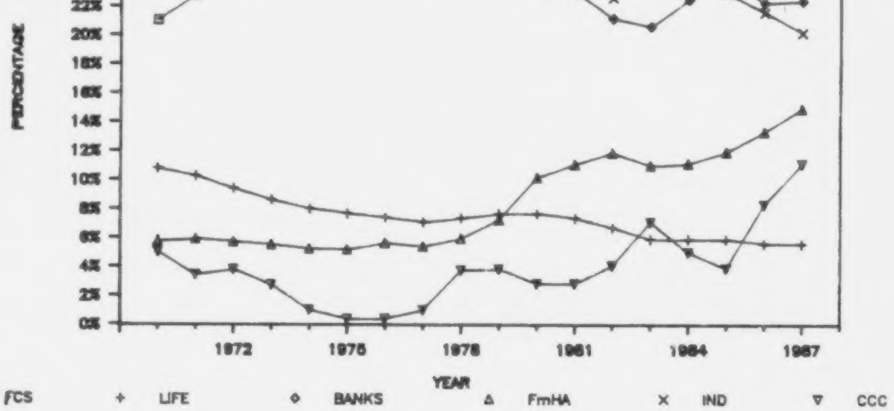
FARM PRODUCTION LOANS

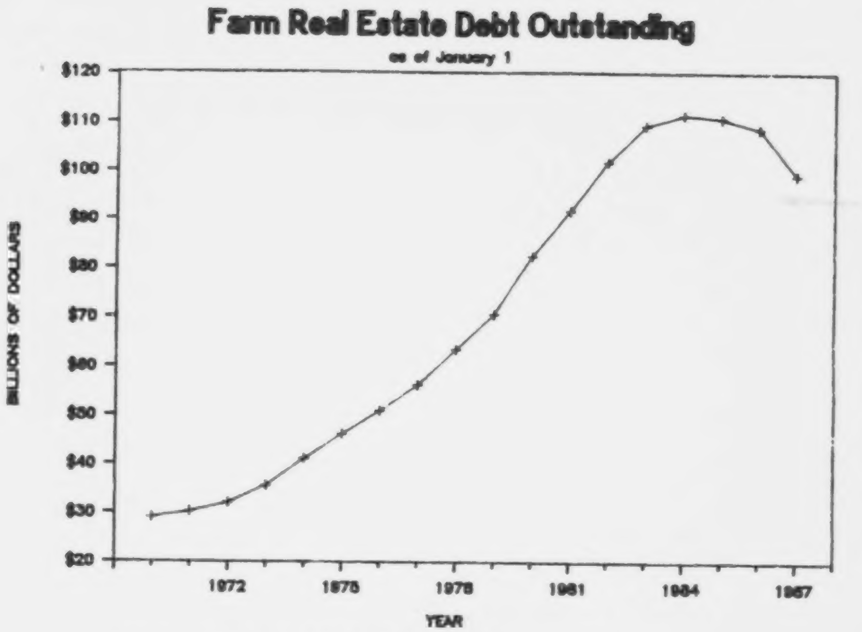


Attachment J
Page 1



Source: USDA unpublished data, February 1987.
January 1, 1987 is preliminary estimate.

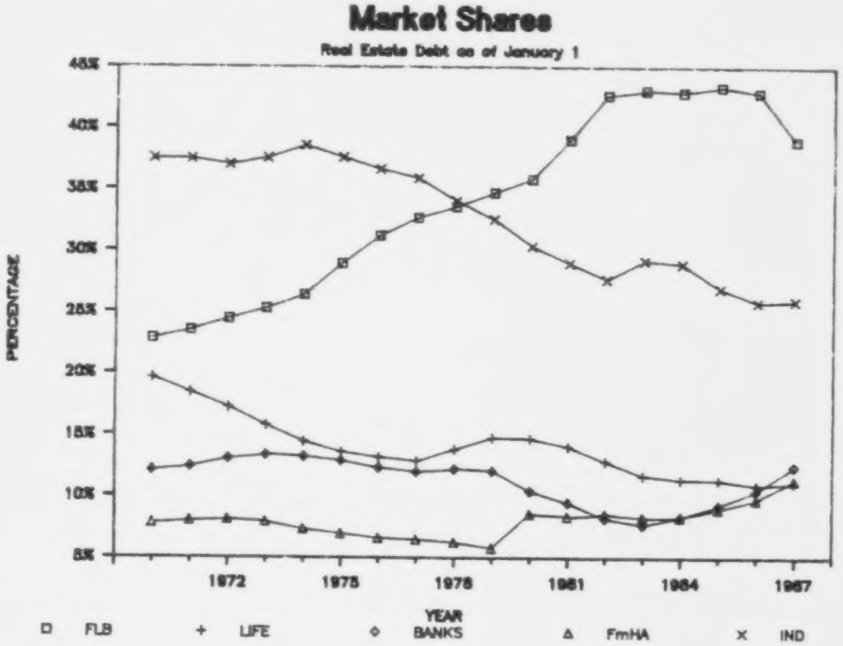




Farm Real Estate Debt Outstanding

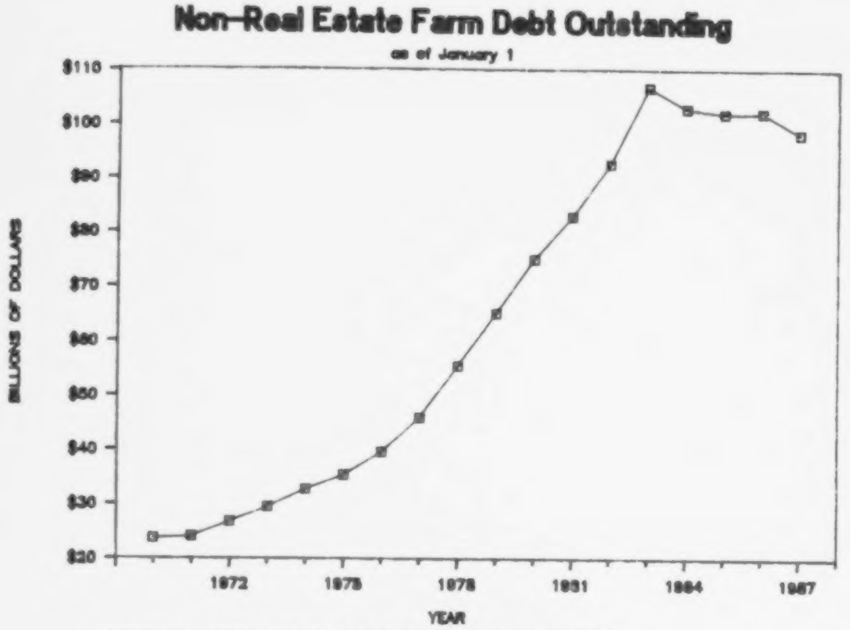
as of January 1

Source: USDA unpublished data, February 1987.
January 1, 1987 is preliminary estimate.

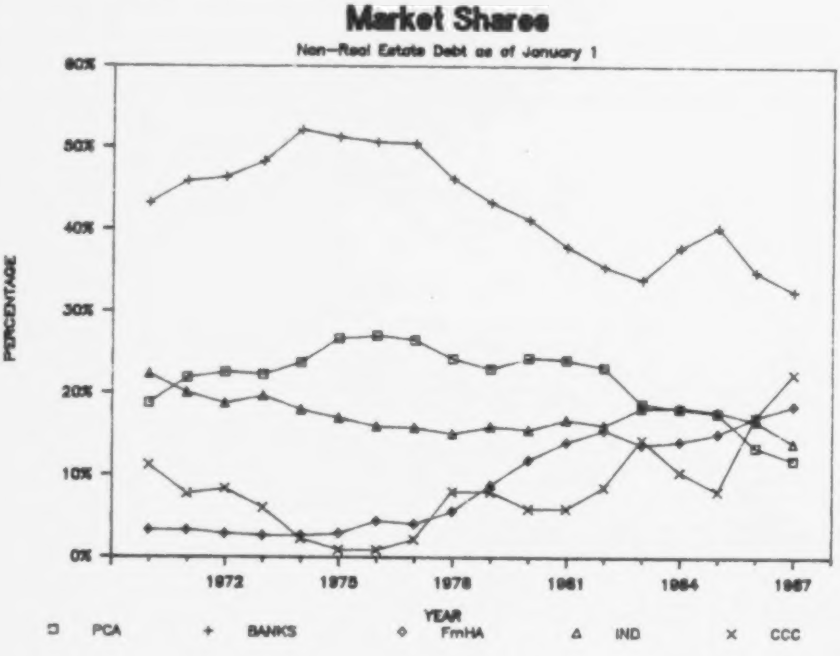


Market Shares

Real Estate Debt as of January 1



Source: USDA unpublished data, February 1987.
January 1, 1987 is preliminary estimate.



SUMMARY OF SIGNIFICANT LITIGATION CONCERNING THE 1985 AND 1986 FARM CREDIT ACT AMENDMENTS

1. Farm Credit Banks of Springfield and Texas vs. FCA and Capital Corporation, Case No. 86-0214-F, U.S. District Court for the District of Massachusetts:

   Issue: Validity of assessment regulations

   Status: Summary judgment for plaintiffs entered February 17, 1987; order modified February 19, 1987. Held: Assessment regulations are both substantively and procedurally invalid; FCA and Capital Corporation permanently enjoined from taking "any action as regards plaintiffs pursuant to said regulations." An expedited appeal is likely.

2. Caprock-Plains FLBA, et al., Plaintiffs, and Federal Land Bank and Federal Intermediate Credit Bank of Texas, Plaintiff - Intervenors, vs. FCA, Federal Farm Credit Board, and Donald E. Wilkinson, Case No. 5-85-267, U.S. District Court for the Northern District of Texas:

   Issue: Validity of FCA's prohibition in 12 C.F.R. 624.114 against reversal of third-quarter accruals under 37-Bank Capital Preservation Agreement; validity of FCA's transfer of funds regulation, 12 C.F.R. 611.1145, which purported to authorize FCA to direct System banks and associations to make transfers of funds or equities to other, financially troubled System institutions.

   Status: Preliminary injunction with respect to 12 C.F.R. 611.1145 granted March 11, 1986.

3. FLB of Columbia, et al. vs. FCA and Capital Corporation, Case No. 3-87-175-16, U.S. District Court for the District of South Carolina:

   Issue: Validity of assessment regulations; seeks to enjoin future assessments and distribution of previous assessments.

   Status: Filed January 29, 1987; motion for preliminary injunction heard February 5, 1987.

4. FLB of St. Paul vs. FLB of Texas and FCA, Case No. 87-0085, U.S. District Court for the District of Columbia:

Issue: Plaintiff seeks declaratory relief to enforce its claim to third-quarter financial assistance under 37-Bank Capital Preservation Agreement; seeks declaratory relief to enforce FCA's prohibition in 12 C.F.R. 624.114 against reversal of third-quarter accruals under 37-Bank Capital Preservation Agreement; seeks to enjoin the Texas FLB from reversing accruals of third-quarter assistance under 37-Bank Capital Preservation Agreement; seeks declaratory relief to prohibit FCA from permitting the reversal of third-quarter accruals under 37-Bank Capital Preservation Agreement.

Status: Filed January 14, 1987. The FLB of Wichita has since joined the FLB of St. Paul as plaintiff in this lawsuit, and the FLB of Spokane has been joined as an additional defendant.

5. FLB of Spokane vs. FCA, Case No. C87-053-RJM, U.S. District Court for the Eastern District of Washington:

Issue: Validity of RAP Regulations, including FCA's prohibition in 12 C.F.R. 624.114 against reversal of third-quarter accruals under 37-Bank Capital Preservation Agreement.

Status: Filed January 21, 1987.

6. FLB of Columbia vs. FCA, Case No. 3-87-250-16, U.S. District Court for the District of South Carolina:

Issue: Validity of FCA's prohibition in 12 C.F.R. 624.114 against reversal of third-quarter accruals under 37-Bank Capital Preservation Agreement.

Status: Filed February 4, 1987.

7. FLB of Baltimore, et al. vs. FCA and Capital Corporation, Case No. H-86-3137, U.S. District Court for the District of Maryland:

Issue: Validity of assessment regulations.

Status: Preliminary injunction granted October 31, 1986.

8. Central Kentucky PCA, et al. vs. FCA and Capital Corporation, Case No. 86-CV02056, U.S. District Court for the District of Columbia:

Issues: Constitutionality of 1985 Amendments; validity of assessment regulations and FCA's Capital Directive No. 1.

Status: Preliminary injunction denied October 3, 1986; Capital Corporation has filed a counterclaim seeking collection of previous assessments against plaintiffs.

9. Northwest Louisiana PCA vs. FCA and Capital Corporation, Case No. 86-3114-S, U.S. District Court for the Western District of Louisiana:

Issue: Constitutionality of 1985 Amendments; validity of assessment regulations and FCA's Capital Directive No. 1.

Status: Injunctive relief denied October 16, 1986.

10. (Consolidated cases) Amarillo PCA vs. FCA and Capital Corporation, Case No. 5-86-098, U.S. District Court for the Northern District of Texas; Bryan PCA, et al. vs. FCA and Capital Corporation, Case No. 5-86-106, U.S. District Court for the Northern District of Texas; Caprock-Plains FLBA, et al. vs. FCA and Capital Corporation, Case No. 5-86-202, U.S. District Court for the Northern District of Texas:

Issue: Constitutionality of 1985 Amendments; validity of assessment regulations and FCA's Capital Directive No. 1.

Status: Preliminary injunction granted in all three consolidated cases October 10, 1986.

11. Central PCA vs. FCA and Capital Corporation, Case No. 86-1995-C-5, U.S. District Court for the Eastern District of Missouri:

Issue: Seeks declaratory judgment regarding constitutionality of 1985 Amendments and validity of assessment regulations and FCA's Capital Directive No. 1.

Status: Injunctive relief was not sought; Capital Corporation has filed a counterclaim seeking collection of previous assessment against plaintiff in the amount of $42.6 million.

12. Sikeston PCA, et al. vs. FCA and Capital Corporation, Case No. S86-0147C, U.S. District Court for the Eastern District of Missouri:

Issue: Constitutionality of 1985 Amendments; validity of assessment regulations and FCA's Capital Directive No. 1.

Status: Judgment for plaintiffs and permanent injunction entered

October 21, 1986. Appeal pending.

13. FLBA of Kingsburg vs. FCA and Capital Corporation, Case No. 86-529-REC, U.S. District Court for the Eastern District of California:

Issue: Constitutionality of 1985 Amendments; validity of assessment regulations and FCA's Capital Directive No. 1.

Status: Injunctive relief denied October 17, 1986.

14. Colorado Springs PCA, et al. vs. FCA and Capital Corporation, Case No. 86-K-1948, U.S. District Court for the District of Colorado:

Issue: Constitutionality of 1985 Amendments; validity of assessment regulations and FCA's Capital Directive No. 1.

Status: An "indefinite" temporary restraining order granted September 26, 1986.

15. Garden City PCA vs. FCA and Capital Corporation, Case No. 86-1759-C, U.S. District Court for the District of Kansas:

Issue: Constitutionality of 1985 Amendments; validity of assessment regulations and FCA's Capital Directive No. 1.

Status: Injunctive relief denied September 29, 1986; Capital Corporation has filed a counterclaim seeking collection of previous assessment against plaintiff.

16. (Consolidated cases) Albuquerque PCA vs. FCA and Capital Corporation, Case No. 86-1189-JC, U.S. District Court for the District of New Mexico; PCA of Eastern New Mexico vs. FCA and Capital Corporation, Case No. 86-1137-JC, U.S. District Court for the District of New Mexico:

Issue: Constitutionality of 1985 Amendments; validity of assessment regulations and FCA's Capital Directive No. 1.

Status: No injunctive relief sought in former action; injunctive relief denied in latter action. Capital Corporation has filed counterclaims seeking collection of previous assessments against plaintiffs.

17. Great Plains PCA, et al. vs. FCA and Capital Corporation, Case No. 86-2119A, U.S. District Court for the Western District of Oklahoma:

Issue: Constitutionality of 1985 Amendments; validity of assessment regulations and FCA's Capital Directive No. 1.

Status: Injunctive relief denied October 3, 1986; Capital Corporation has filed a counterclaim seeking collection of previous assessments against certain of the plaintiffs.

18. Capital Corporation vs. FLBA of Bridgeton, et al., Case No. 87-0006-F, U.S. District Court for the District of Massachusetts:

Issue: Seeks an order to compel payment of assessments against three defendant FLBAs pursuant to 1985 Amendments and assessment regulations.

Status: Filed January 16, 1987; suit is in the initial pleading stage.

19. Capital Corporation vs. Coastal Bend PCA, et al., Case No. A-87-CA-073, U.S. District Court for the Western District of Texas:

Issue: Seeks an order to compel payment of assessments against defendant PCA and two defendant FLBAs pursuant to 1985 Amendments and assessment regulations.

Status: Filed February 6, 1987; suit is in the initial pleading stage.

Attachment L
Page 1

Farm Credit Corporation
of America

P.O. Box 5130
Denver, CO 80217
5500 South Quebec St
Englewood, Colorado 80111
303/740-4200

August 18, 1986

The Honorable Frank W. Naylor, Jr.
Chairman
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Re: Comments on FCA Capital Corporation
Assessment Regulations - Sec. 611.1142(h)

Dear Chairman Naylor:

The Farm Credit System (the "System") is pleased to respond to the Farm Credit Administration ("FCA") request for public comments on final regulations concerning the funding activities of the Farm Credit System Capital Corporation ("Capital Corporation") published in the Federal Register on June 12, 1986.

The System recognizes that these regulations are critical to implementation of the Farm Credit Amendments Act of 1985 (the "1985 Amendments"). The urgent needs of those System institutions presently experiencing severe financial stress may not be met if FCA's regulations are determined to be invalid. Indeed, the entire System will suffer if the self-help efforts mandated by the 1985 Amendments are frustrated by court determinations that FCA's regulations do not carry out the intent and mandate of the 1985 Amendments. The essence of that mandate is that System institutions must be in a position to provide credit to eligible borrowers on reasonable and competitive terms. Congress recognized that it would make no sense to require contributions from any System institution that could not provide that level of service to its borrowers.

In testimony provided by FCCA at the recently concluded hearings concerning the request by the Amarillo PCA to withdraw from the System, we fully supported implementation of the self-help program contemplated by the 1985 Amendments. Nevertheless, as set forth in the attached detailed comments, it is the consensus view of FCCA and all 37 System Banks that the regulations, as presently written, are vulnerable to serious challenge and should promptly be revised in order to comply with the statutory direction given to FCA in Section 4.28C of Farm Credit Act of 1971, as amended (the "Act"). (Due to the great significance of these regulations, certain System Banks have elected to file separate individual comments. However, as noted above, all System banks have reviewed and approved the attached System comments.)

We believe it is noteworthy that these comments are submitted on behalf of both projected contributors to the Capital Corporation and projected recipients of financial assistance. FCCA and all System Banks are committed to the successful operation of the Capital Corporation if it operates within the parameters established by the Congress in the 1985 Amendments. FCA's regulations obviously play a crucial role in determining whether the Capital Corporation will in fact operate in the manner contemplated by Congress, and we trust that FCA expeditiously will act upon the suggestions set forth in the attached System comments.

FCCA will, of course, be pleased to respond to any questions you may have concerning this matter.

Sincerely,

Brent Beesley

H. Brent Beesley
President and Chief Executive
Officer

HBB:rt

cc: All Farm Credit System Bank and Service Entity CEOs/Presidents
FCCA Board of Directors
Sutherland, Asbill & Brennan

enclosure

STATEMENT OF H. BRENT BEESLEY

I appreciate this opportunity to make a statement today on behalf of the Farm Credit System. My name is Brent Beesley. I am the Chief Executive Officer of the Farm Credit Corporation of America and a member of the Farm Credit Council's Legislative Committee.

The Farm Credit Corporation of America was organized in July 1985 by the 37 Farm Credit Banks to establish policy on national issues and to be the System's national spokesman. At this moment, the three banks in the Texas District are not members of Farm Credit Corporation of America. The Texas District Board, however, has endorsed this statement. All 37 banks are members of the Farm Credit Council.

To be allowed to speak candidly at a public hearing about the actions and regulations of a federal agency is a precious American freedom. We appreciate the Farm Credit Administration (FCA) for calling this hearing. I believe that both the FCA and the System are working in good faith to find solutions that will strengthen the System and benefit the American farmer. These remarks are intended to be constructive.

My comments today pertain to FCA's Temporary Regulations on Regulatory Accounting Practices (the RAP Regulations). First let me express our appreciation to the FCA Board for promulgating the RAP Regulations to implement the Farm Credit Act Amendments of 1986. We appreciate the technical corrections to the RAP Regulations made on January 15, 1987.

I am submitting with my statement today a copy of the technical written comments that have been submitted to FCA on behalf of all 37 Farm Credit Banks. Mac Asbill, Jr. and Warren Davis, outside counsel to FCCA, are prepared to respond to any questions you may have concerning these comments. While you will hear today differing views from within the System concerning one aspect of the RAP Regulations, namely the status of capital preservation accruals booked during the third quarter of 1986, it is important for FCA to accept and appreciate that the System has reached agreement on all other significant issues relating to the RAP Regulations.

During the last five years, the value of American farm land has fallen sixty percent in certain areas and an average of thirty percent nationwide. The Farm Credit System has been thrown into a period of unprecedented financial difficulty. Indeed, after seventy years of virtually no loan losses, during 1985 and 1986 alone, the System's provisions for loan losses exceeded $4.767 billion. The total net losses for the System during this two-year period were $4.602 billion.

Within the last sixteen months, Congress passed and the President signed two very important laws which were intended to help farmers and ranchers by strengthening their cooperative credit delivery System. Despite this recent legislation, many borrowers remain concerned about the safety of their investment in the System. Loan volume is down again in 1986 which is to be expected in this economy, but so is our share of the market. This loss of market share is very detrimental to our recovery plans. Significant actions are being taken by the System to rebuild our market share. However, as I will explain, resolution of our problems will require a major cooperative effort by the System and its regulator. Such cooperation would, in our view, be consistent with FCA's role as an arms' length regulator.

There has been much attention paid of late to the numerous lawsuits recently filed by and between various System entities. These suits are used by some to portray the System as being in disarray. This is not the case. The System is united on most of the issues involved, and FCA is the primary defendant in virtually all these cases. Most of the lawsuits and the resulting loss of borrower confidence are the result of the System's view, confirmed by the recent decision of the Massachusetts Federal District Court, that FCA's Assessment Regulations are invalid because they ignore some important mandates of the 1985 Amendments.

The remaining lawsuits pertain to the RAP regulations. While the January 26, 1987, technical corrections resolved many of our concerns, there are still several provisions in the RAP Regulations that need to be modified to achieve the objectives of the Congress regarding the 1986 Amendments.

It would be of marginal value, however, to amend the RAP Regulations alone. We must work together to develop a broader solution to all the lawsuits and the borrower confidence issue. This solution will require a cooperative effort by FCA and the System to develop regulations that conform to the 1985 and 1986 Amendments by permitting full use of RAP and by establishing a fair and equitable scheme for sharing limited System resources. The viability of healthy institutions witnin the System cannot be jeopardized. We recognize that this will call for difficult judgement and actions on the part of both FCA and the System.

The Farm Credit Bank presidents have embraced a proposal developed by the System Finance Subcommittee of a more complete solution which we are now working to develop more fully. (This concept has also been approved by the Board of Directors of the Farm Credit Corporation of America and the Legislative Committee of the Farm Credit Council.) The outline of this solution is as follows:

1. FCA would amend its Assessment Regulations to conform to the 1985 Amendments. This might result in a single, up-front assessment by the Capital Corporation and an equitable formula for future assessments if necessary. For this to work, Farm Credit System entities must know that the limits placed on these assessments will allow them to

remain viable and to provide credit to their members on a competitive basis.

2. FCA would amend the RAP Regulations to allow full utilization of RAP before the scarce resources of the Capital Corporation are to be deployed. Currently, the Capital Corporation must certify that it is unable or unwilling to provide assistance before the full use of RAP can be applied.

3. FCA would amend the RAP Regulations to allow the unwinding of the assistance voluntarily shared among System institutions back to February 23, 1986, which was the date the Capital Corporation was rechartered pursuant to the 1985 Amendments. Amounts taken from receiving banks for the period February 23, 1986, through June 30, 1986, would be replaced on similar terms by the Capital Corporation. Amounts returned to contributing banks would be considered for assessment pursuant to the amended assessment regulations.

4. The System would utilize its own internal mechanisms to help ensure compliance by all System entities. There has been little enthusiasm to bring such pressures to bear to date as every District is on record as believing that the current FCA assessment regulations are invalid and illegal.

5. FCA would make it clear to all concerned that if and when the full utilization of RAP and the full utilization of the available resources of the Capital Corporation are not sufficient to protect the borrowers' stock of System institutions, FCA would certify the need for federal financial assistance to the Treasury as outlined in the 1985 Amendments. This is not intended to imply that every System entity has a right to survive. We consider it appropriate for FCA and/or the Capital Corporation to restructure non-viable entities. At the same time, we believe that it makes good business sense and is consistent with the clear intent of Congress reflected in the 1985 and 1986 Amendments that the members' stock be protected. We believe such support by FCA will help eliminate or minimize the actual need for Federal Financial Assistance by reassuring the System stockholders and thereby helping the System to retain market share;

6. If necessary, the 37 Farm Credit System banks would agree to share collateral.

While there may be some entities that will resist parts of this proposal, from the System's viewpoint, a solution along these lines is feasible. This solution would permit the Capital Corporation to fulfill its assigned role, result in the settlement of most of the lawsuits filed and judgements entered against FCA and would also increase borrower confidence in the System.

We do not consider it necessary or appropriate to ask Congress for any additional legislation until FCA and the System have fully implemented the powerful tools that we have already been given. However, if the System is to continue its 70-year-old role as a farmer-owned and controlled source of dependable and fairly priced credit, we must be able to provide greater assurance to our borrowers that their stock is safe. These borrowers are not investors in the traditional sense. They have no choice in the price they pay for their stock. They have no choice in the Farm Credit System entity from which they borrow. In many cases, the losses suffered by their institution are solely the result of sharing capital with distressed institutions and have little to do with performance of their own institutions.

At the present time the critical need is to rebuild borrower confidence in the System. We seek FCA's cooperation in this regard through amending the Assessment and RAP Regulations so that some version of the solution I have outlined above can be implemented. We also solicit your help in building confidence in the System through positive indications in your public appearances and statements of our joint commitment to bring the System through these troubled times.

Again, we appreciate this opportunity to participate in this important hearing. We recognize the difficulties that you face as our regulator in these stressful times. It is clearly in the System's best interest that you be a successful regulator. We trust that the lawsuits and other divisive issues that confront us will soon be resolved. Thank you.

Attachment N
Page 1

EVALUATION OF DISTRICT IMPLEMENTATION OF FCS GUIDELINES AND DEFINITIONS FOR RESTRUCTURING TROUBLED LOANS

February 6, 1987 Districts	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Date Adopted	None	5/86	5/86	5/86	5/86	4/86	5/86	5/86	5/86	8/86	4/86	6/86
Date Implemented	None	8/86	8/86	6/86	7/86	7/86	5/86	6/86	6/86	FICB 9/86	4/86	6/86
Program says when...	There are not significant levels of delinquent or non-accruing loans in the Springfield District.											
Cooperative/good faith		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Borrower viability plan		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Minimize loss		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Outlines objectives												
Greatest return/protect stockholders		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Use Federal/State programs		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Forbear versus Restruct/ Consistent		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Defines forbearance		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Forbearance points stated...												
Good Faith		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Applying proceeds/income		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Maintaining assets		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Capable of recovery		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Defines troubled debt restructuring		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Outlines examples of TDR												
Transfer of assets		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Granting of equity interest		Yes	Yes	Yes	No	No	No	Yes	Yes	Yes	Yes	Yes
Modify terms of debt		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Requires analysis on potential loss loans with cost/benefit documented		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Outlines factors to consider												
1. Good faith, maintaining collateral, pledged assets mgt. skills, lifestyle		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
2. Current financials		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
3. Appraisals/Project NRV		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
4. Legal audit of file		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
5. Viable cash flow after...		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
6. Negotiate concessions other lenders		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
7. Use Fed/State programs		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
8. Advice to seek legal/tax counsel		Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
9. Set aside preferred to forgiveness		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
10. Select least cost alternative		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Address operational issues												
1. One district focal point		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
2. Control system		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
3. GAAP accounting		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
4. Review state laws		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
5. Nonaccrual loans reviewed		Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	Yes	Yes
6. Information systems/reports		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes

O050/DH1 2/6/87

Attachment N
Page 2

EVALUATION OF DISTRICT IMPLEMENTATION OF FCS GUIDELINES AND DEFINITIONS FOR MANAGEMENT AND DISPOSITION OF ACQUIRED PROPERTY

February 6, 1987

Districts	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Date Adopted	None	5/86	5/86	5/86	5/86	4/86	6/86	5/86	6/86	FICB 8/86	4/86	6/86
Date Implemented	None	8/86	8/86	6/86	7/86	3/86	6/86	4/86	6/86	FICB 9/86	9/86	5/86
Objective: maximize Net Present Value	There are not significant levels of delinquent or non-accruing loans in the Springfield District											
1. Convert asset to earning market rate		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
2. Promptly market at highest price		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
3. Manage to maximize rental income		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
4. Manage for viable real estate market		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
5. FCS good steward of land		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Provides for 12 month turnover period		Yes	Yes	Yes	Yes	No	Yes	No	Yes	Yes	Yes	Yes
Defines competitive range		Yes	Yes	Yes	Yes	No	Yes	No	Yes	No	Yes	Yes
Provides for terms at lower end of competitive range		Yes	Yes	Yes	Yes	No	Yes	No	Yes	Yes	Yes	Yes
Pricing policy balanced with turnover period and terms and considers												
1. Comparable sales		Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
2. Property rates of return		Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	No	Yes	Yes
3. Anticipated rates of return demanded by investors		Yes	Yes	Yes	Yes	No	Yes	No	No	No	Yes	Yes
4. Exception for high return property		Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	No	Yes	Yes
Addresses FC act provision for sale of larger than family size farms		Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Addresses operational issues												
1. Consider System image/training		Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	No	Yes	Yes
2. One district focal point		Yes	Yes	Yes	Yes	No	Yes	No	Yes	No	Yes	Yes
3. Information System/reports		Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes

Attachment N
Page 3

NUMBER AND AMOUNT OF FORBEARANCE ACTIONS AND FORMALLY RESTRUCTURED LOANS AS OF DECEMBER 31, 1986

District	Forbearance Actions*		Formally Restructured Loans**	
	No.	Amount ($1,000)	No.	Amount ($1,000)
Springfield	803	$ 41,214	1	$ 23
Baltimore	922	43,023	11	9,545
Columbia	5,222	141,974	84	23,916
Louisville	1,127	97,618	458	105,472
Jackson	498	3,547	4	1,121
St. Louis	255	7,041	12	7,432
St. Paul	-- Not Reported --		1,556	202,223
Omaha	498	10,492	344	49,349
Wichita	1,820	219,963	927	180,750
Texas	416	68,157	2	1,586
Sacramento	243	45,682	73	46,378
Spokane	2,238	263,099	269	105,299
System	14,042	$890,958	3,741	$733,094

*Forbearance actions include extension of maturity date, deferment of loan installments, reamortizations, waiver of loan covenants and subordination.

**Troubled debt restructuring includes transfer of assets to the lender to fully or partially satisfy a debt, grant an equity interest to the lender to fully or partially satisfy a debt, modify the terms of a debt by:

- Reducing the stated interest rate for a period of years
- Extending the maturity date at a stated interest rate lower than the current market rate
- Reducing the principal amount
- Reducing accrued interest

R050/MX1
2/24/87

STATEMENT OF SAM G. EBERLY, CHAIRMAN OF THE BOARD, FARM CREDIT SERVICES OF WICHITA

Mr. Chairman and Members of this Subcommittee: My name is Sam Eberly, I am Chairman of the Board of Farm Credit Services of Wichita and a member of the board of directors of both the Farm Credit Corporation of America and the Farm Credit Council, the trade association for the Farm Credit System.

I appreciate the opportunity to testify today as you begin to look into the issues confronting the Farm Credit System.

Mr. Chairman, as you know, I am a farmer. That's my full-time job. What I do as a director of the 9th Farm Credit District is second to that, although it seems I'm spending more and more time as a director trying to solve the problems which face our district and the System as a whole.

Being a farmer and a director has meant learning to confront frustration. When a neighbor or close friend loses his farm, he's lost both a way of life and the only occupation he's ever had. As a farmer, you know that the same thing could happen to you. As a director, we have sat in the board room and seen the financial condition of the Farm Credit System deteriorate, and known, Mr. Chairman, that in the final analysis, only a turnaround in the agricultural economy will save the Farm Credit System. Farmers must make a profit in order to repay their loans.

You are acquainted with our district, Mr. Chairman. You know about our problems from your constituents. But for the record, I would like to take a few minutes and recall what has happened in the 9th Farm Credit District this past year.

Our district serves four states: Kansas, Oklahoma, Colorado and New Mexico. As of January 1, 1987, we served our farmers, ranchers, and cooperative members through more than 60,000 loans totaling $4.4 billion. Of that amount, approximately $771 million were nonaccrual loans. That's nearly 18 percent of our total volume. Compared to a year ago, our loan volume is down by nearly 20 percent and nonaccrual loans are up by 15.6 percent.

We could see things deteriorating during 1986, but by mid-year, we had completed a detailed loan-by-loan analysis of our Land Bank portfolio. As a result, we substantially increased our loan loss reserves effective June 30, 1986. Soon thereafter, we began discussions with the Capital Corporation, the System entity established to be the vehicle through which System capital could be channeled to financially-stressed districts.

We were also told that our regulator, the FCA, would soon present its examination of our district. The FCA report, completed in June, was finally presented to the district on December 16.

It was nearly five months after the first contacts with the Capital Corporation that an assistance agreement was agreed to by the board.

One reason for our frustration is that there have been two conflicting signals given to our district board. One is that the district must "get tough" and collect as much as it can from farmers who aren't making payments on their loans. The other is that the district must restructure loans and leave troubled borrowers in place.

We do want to restructure loans, as Congress and the Chairman of FCA are urging us to do. But a different signal comes from the Examination and Supervision staff at FCA, which is telling us to collect in full. That contradiction is one big problem we're encountering.

Another is the criticism about our operating expenses. For the 9th District, I want to set the record straight. In the past 14 months, we've cut district operating expenses by 24 percent from $68 million to $52 million, not counting the Capital Corporation expenses for the Special Assets Group. We've reduced staff at the district level by 20 percent. Last month we made the painful decision to reduce benefits to our headquarters staff, which saved our stockholders half a million dollars. In December, we sold our district headquarters office building. This allowed us to reduce our per square foot cost, permitted us to use that capital to reduce bond debt, and permitted us to enter into a short-term lease with a long-term option if needed. We've sold 8 association office buildings not being used and we have under study the sale and lease-back of nearly a dozen more.

We are doing everything that we can to reduce expenses, while ensuring that we maintain necessary services to borrowers. And that, Mr. Chairman, is what I want to spend the balance of my time talking about.

I believe, quite strongly, that the only reason that there should be a Farm Credit System is that it benefits the farmers, ranchers and co-ops who are its owners and borrowers.

What are those benefits:

(a) A dependable source of credit at competitive rates; and

(b) Efficient and cost-effective delivery of credit. As a director and a borrower, that's what I expect us to provide.

How are we living up to those goals?

I can tell you in the 9th District, Farm Credit is one of the few entities still lending to agriculture. Some insurance companies have pulled out altogether. We haven't. And as a result of new district management under Vern Peckham, we're working with all staff to let them know that no one is throwing in the towel. We're here to stay.

The Special Assets Group (SAG) in our district began work on December 1, 1986. Since that time, they have worked very effectively with troubled borrowers.

As of February 19, the Special Assets Group had completed work on 738 loans. In more than 300 of these cases, our SAG specialists have restructured loans or found some other way to keep the member on the land. And in 675 cases—more than 90 percent—the SAG specialists have reached an agreement with the borrower outside of court, and managed to avoid foreclosure. That's a good record, in only 2½ months.

We believe there are many members who can be rescued without incurring unreasonable losses to the 9th District by acting early in individual cases. To accomplish this objective, we will formally initiate the next phase of our debt restructuring program with special emphasis on helping troubled borrowers before there is no hope for survival. Our goal is to prevent movement of property into nonaccrual and acquired property status. This district initiative is in addition to the Capital Corporation Special Assets Group.

At the same time, we must not lose sight of the paying customer—the farmer and rancher who manages to keep his loan current, in spite of these hard times in agriculture. We have attempted to provide much-needed rate reductions for those farm families too.

In part as a result of the '86 Amendments, interest rates to the majority of Farm Credit Service borrowers in the past 7 months have declined by 1 to 1¾ percentage points. For our best PCA and FLBA members, rates are down to 9.75 percent. While this is a good start at maintaining the business of our best borrowers, it could be better.

Mr. Chairman, I'm not going to tell you that our problems are over because they aren't. I am here to tell you that the Farm Credit System is the farmers, ranchers and cooperatives who are its members, no more and no less. Hundreds of thousands of farmers have supported this system for decades and made it grow. They've kept faith with us. Now it's time for us to demonstrate to them that this System is worth saving.

Mr. Chairman, the Farm Credit System was established by Congress to meet agriculture's need for credit when it was not available elsewhere. That major purpose for the System has not changed. The issue which everyone is trying to come to grips with today is how to ensure that credit continues to be made available to farmers at reasonable rates while the System works through the problems which have roots in a sick ag economy. As I said when I began my statement, profitability in agriculture is the only long-term solution toward solving the problems of the Farm Credit System.

Mr. Chairman, I'll be pleased to answer your questions.

White, Rankin Co., L.P.A.
Columbus, OH, February 25, 1987.

Hon. David Boren,
U.S. Senate, 453 Russell Building, Washington, DC 20510

Dear Senator Boren: I enclose copies of materials that we would like inserted in the record of the February 26th hearing of the Subcommittee on Agricultural Credit and Rural Electrification of the Committee on Agriculture. They are submitted on behalf of Production Credit Association of Northern Ohio, Marion Production Credit Association, Central Kentucky Production Credit Association, Jackson Purchase Production Credit Association, and Chattanooga Production Credit Association.

The first item is a letter from Russell Polston, president of the last named association to you dated February 23, 1987. The second is the testimony of Dean Biery, a director of Production Credit Association of Northern Ohio before the Farm Credit Administration delivered on June 10, 1986.

We would like to have an opportunity to present live testimony at this or a future hearing on the Farm Credit System.

Sincerely,

White, Rankin Co., L.P.A.,
John C. Deal.

Enclosures.

CHATTANOOGA PRODUCTION CREDIT ASSOCIATION,
Chattanooga, TN, February 23, 1987.

Hon. DAVID BOREN,
U.S. Senator, 453 Russell Building, Washington, DC.

DEAR SENATOR BOREN: We appreciate the important items you helped to incorporate in the 1985 Farm Credit Amendments, such as over-chartering of the local institutions, prohibiting the Capital Corporation assessing the local associations to the extent funds could not be made available to farmers at competitive rates and funds could not be taken to the extent that would make the Farm Credit Institutions nonviable.

As Chairman of the Senate Agriculture Subcommittee, we feel you desire as much information as possible to formulate legislation that will determine the course of Farm Credit in the future. You will also have great influence in the System's future.

We have been in the Farm Credit System for 36 years and have worked at both the district and local level. We have been CEO for the past 28 years and offer the following for your consideration.

(1) The law needs to be changed to prohibit local association funds being taken without stockholder approval. The PCA's became completely farmer owned in the 1950's. Our association paid off government capital January 3, 1952 and was given a certificate from the Governor of the Farm Credit Administration stating the association was completely owned by its members. We are enclosing a copy of this certificate.

Funds cannot be taken from any corporation without stockholder approval. The 1971 Act required District Banks to share in the obligations of the Farm Credit Bonds, but the local PCA's are responsible for their loans with the Federal Intermediate Credit Bank and not responsible for loans made by other Farm Credit Institutions, which they have no control.

There are those who say that PCA's would not have had any funds if they had not been a part of the Farm Credit System. We can assure you there would not be surplus funds in any PCA if stockholders had known they did not own the association and the assets could be taken at will. They have been told for over 50 years the association belonged to them and they have made sacrifices for the association because of this information. Chattanooga PCA sold "A" stock to farmers to repay government funds. They were not promised any dividends and were not even promised they would get their money back. They bought this stock because FCA and the District Bank told them the association belonged to them.

In the past few years, being a part of the system has been a minus rather than a plus.

(2) Farm Credit Institutions should be operated as any other free enterprise system. If they become insolvent and cannot succeed in the business environment, they should be allowed to fail just like any other business without requiring someone else to bail them out that had nothing to do with their failure. The local boards and stockholders of the institution should have the authority to manage their affairs and be accountable for the results.

(3) The government should consider making a loan to institutions that have the potential to succeed and become viable. However, institutions that do not have the potential to succeed and become viable should not receive any assistance. Any government funds placed into a Farm Credit Institution should be repaid when the institution becomes profitable. This was the method that was used to begin the Farm Credit System.

(4) While it may not be politically possible, it would help the farmers if the government backed the bonds. This would cost the government very little, if any, and would make credit available to the farmer at much lower rates.

The PCA system has been in existence over 53 years and the Federal Land Bank much longer and no bondholder has lost any money. Therefore, if the government had backed these bonds over the years, there would be no cost to the taxpayer and the farmer could have received his funds much cheaper.

(5) There are too many Farm Credit Institutions supported by the farmer. You have FCCA; Farm Credit Capital Corporation; Farm Credit Funding Corporation; Farm Credit Administration and District Banks above the local association. All of these organizations are staffed by high priced employees. All these institutions are advocating cutting costs, making it necessary to close local offices, which is where loans are made and farmers receive service. The local offices are the backbone of the total system. Without local offices, none of the above institutions will survive.

(6) There is no need for a PCA system and a separate Federal Land Bank system with a separate board to operate the system. The farmer needs one Farm Credit association that makes long term and short term loans with the same loan officer, the same general manager and the same board.

(7) There only needs to be one responsible audit a year. Each Farm Credit Institution is audited by an independent auditor, FCA and the District Banks. This is expensive for the farmer and hurts service to the farmer. It is difficult for the local institution to meet the requirements of three different auditors.

Our desire is to create an efficient Farm Credit Institution that will meet the needs of the American farmer. We hope the above comments will be helpful to you.

Sincerely,

RUSSELL POLSTON, *President.*

FARM CREDIT ADMINISTRATION

IN THE MATTER OF: AMARILLO PRODUCTION CREDIT ASSOCIATION VOLUNTARY LIQUIDATION

STATEMENT OF DEAN BIERY, VICE CHAIRMAN OF THE PRODUCTION CREDIT ASSOCIATION OF NORTHERN OHIO

Mr. BIERY. Thank you, Mr. Auberger.

I am Dean Biery, the Vice Chairman of the Board of Northern Ohio. And accompanying me to the table is Mr. John Deal, our counsel from White, Rankin Company in Columbus.

I am here for our board of directors to support the efforts of the Amarillo Production Credit Association to reorganize in the interest of continued service to its stockholders. Speaking for our stockholders, we think that Amarillo Production Credit Association's request should be granted for the following reasons:

(1) Local ownership and control of PCA's must be preserved;

(2) Threatened transfers of assets and equities by the Farm Credit Administration will destroy the base of good customers needed to operate a safe and sound PCA; and

(3) The value of any PCA's investment in Federal Intermediate Credit Bank stock is threatened by the FAC's regulations and Farm Credit Amendments Act of 1985.

At the outset, we want it clearly understood that we agree with Amarillo PCA that because it is reorganizing rather than dissolving or liquidating no FAC approval is required. Even so, we understand the reasons Amarillo PCA is cooperating with FAC requests for information. We have also tried to be a cooperative as possible, even though we have also found it necessary to sue the FCA.

There are several organizations that claim to speak for the good of the Farm Credit System, including the FCA, the FCCA, the Farm Credit Council, the Federal Farm Credit Banks Funding Corporation, and the Farm Credit System Capital Corporation, but they don't speak for our farmers.

To understand why Amarillo PCA needs to reorganize you have to understand that they are not alone in having to protect themselves against FCA transfers of their net worth. The trend toward more centralization of control over the assets and net worth of PCAs all over the country threatens to destroy any local control farmers and ranchers have over their PCAs.

We find ourselves in the same position as Amarillo PCA. After having worked for 50 years to build our PCA and help the farmers who depend on us, we face the loss of everything we have built. Most of our farmers have from $2,000 to $5,000 invested in the stock of our PCA. If our assets are taken, it won't matter that we still have the formalities of a local charter. These farmers will have lost what has been built up over 50 years.

We are considering reorganizing into a credit union, if necessary, to protect our stockholders. Recently, the Ohio House of Representatives passed by a 95-to-1 vote a bill that would allow us to do so.

Unless Amarillo PCA is able to reorganize, it will eventually face the same situation we face, that is, it will be weakened by the FCA in an attempt to strengthen other associations. Those other associations need help from outside the Farm Credit System. In the meantime, well-run PCA's must be allowed to continue their successful operations. In that way the Farm Credit System can retain the good credit risks that can restore it to health.

Unless Amarillo PCA can reorganize, it will eventually lose its better credit risks and start to deteriorate. If it can reorganize, it will be able to retain these farmers and ranchers and participate in the System as an Other Financing Institution or

OFI. The Farm Credit System will be better off with a healthy OFI than a defunct PCA.

Amarillo PCA's future can best be understood by looking at our PCA's past. In the 35-year period from 1950 to June 30, 1985, PCA of Northern Ohio loaned more than $1 billion. It has less than $1 million on cumulative loan losses from the date it was chartered in 1934 until June 30, 1985. Northern Ohio, under local control, has been and continues to be profitable despite what many regard as the most adverse agricultural conditions in 50 years. It has been and is the largest agricultural lender within the 6-county area in which it operates.

There are two reasons for our success.

First, our stockholders have had a great deal of confidence in the strength of the PCA. When they borrow money they are required to invest an amount equal to an 8 percent of the loan and to maintain their investment at that ratio during the life of the loan. They have always been confident that this investment can and will be returned to them as the loan is paid.

Second, the PCA has historically loaned money at very favorable rates, typically, as low as any Production Credit Association in the Fouth Farm Credit District, comprising Ohio, Indiana, Kentucky and Tennessee.

These same two factors, confidence and low interest rates, combined to give both Amarillo PCA and PCA of Northern Ohio a very significant market advantage over competing lenders. As a result, both associations have been able to attract the best of the agricultural credit risks and to enable their stockholders to reduce interest expenses, which results in a lower overall operating cost, further helping these stockholders to operate successfully in a difficult economic period. In turn, this has enabled both PCAs to operate with minimal credit losses, which, of course lowers operating costs.

We don't claim all of the credit for the success of our stockholders, but under local control we have helped them be successful. It is a partnership that has benefited everyone, especially the Farm Credit System. In 1981 to 1985 we have paid $637,000 in net loss sharing; $41 million in interest to the FICB; and invested $3.7 million in stock of the FICB. Yet, we are now facing the same decision as Amarillo PCA, not because we want to, but because we have to.

Here's why. First, we face the same threat that under FCA regulations and the Farm Credit Amendments Act of 1985, our assets and net worth will be taken from us.

Second, we face the prospect that our investment in FICB stock, an investment that is already much more than we can afford, will be worth less because the FICB will suffer a net worth transfer.

Even without such a transfer, we wrote off $114,000 on our FICB investment in 1985.

Third, the amount we are able to lend if being severely restricted because of the amount of money we have invested in FICB stock.

Fourth, we are faced with possibly discriminatory treatment.

And, fifth, the System's expenses are going to go out of control.

First, the threat to the net worth of PCAs. Recently, as agricultural conditions in the United States deteriorated, the quality of agricultural debt began to be called into question. Sixty-eight commercial banks with significant amounts of agricultural loans in their portfolios were closed in 1985, up from 32 in 1984. In mid-1985, the Farm Credit Administration revealed similar problems in agricultural debt held by Farm Credit System lenders. As a result, negative accounts in the news media began to mention Farm Credit System securities. The yield differential between U.S. Treasury securities and those of the Farm Credit System, which had been almost insignificant, rose to about one-fifth of a percentage point.

A Farm Credit Administration regulation that was designed to calm the credit markets has had the opposite effect. The regulation purports to give the Farm Credit Administration the authority to transfer assets and equities among Farm Credit System lenders. Immediately after it was adopted, the interest rates on Farm Credit System securities increased from about one-fifth of a percentage point over the yield on comparable U.S. Treasury securities to about nine-tenths of a percentage point over Treasuries.

According to accounts in the press, the market feared that the regulation would drive the better credit risks out of the Farm Credit System.

The yield differential is now about two-fifths of a percentage point, still double that of last summer.

The Farm Credit Banks generally opposed the regulation. Amarillo PCA filed suit in federal court to have it set aside. So did we. In the meantime, however, the Farm Credit Amendments Act provides a new threat in the form of the Farm Credit

System Capital Corporation. The Farm Credit System Capital Corporation will increase our costs and reduce the amount we can lend to farmers. That means that we will be less profitable and that the System will receive less income from us.

Second, overinvestment in FICB stock. Our investment in FICB stock has increased by about 60 percent in four years. The amount we have been required to invest in FICB of Louisville exceeds what other Intermediate Credit Banks require their PCAs to invest.

Table 1 compares the Class B stock of the FICBs with their total assets. FICB of Louisville has a capital ratio more than three times that of the FICB of Texas. If Amarillo PCA does not reorganize it can expect to face increasing investment requirements. This will result in both a greater investment in non-earning assets than they can afford and less money available for lending to farmers and ranchers.

Table 2 shows the increasing amount of our net worth invested in FICB stock. And you can see that from 1981 to 1985, while our net worth dropped from 13.1 million to 11.2, our increase in investment in the FICB rose from 5 million to 8 million or a percentage increase of 38 to 71 percent.

The increased investment in FICB stock effectively cost us about $300,000 per year, which we have to pass along to the farmers as about six-tenths of a percent additional interest. This costs our average stockholder about $300 per year in additional interest. The increased investment is also one of the reasons our loan portfolio has shrunk by more than 40 percent in the last four years, to the point where we now have more of our own funds invested in the FICB than in loans to farmers.

Next, restrictions on lending. Under Section 614.4190 of the FCA's regulations, our ability to borrow directly from the FICB is limited. The net result is that in our particular case we could borrow approximately 95 percent of our loan portfolio. In recent years we have maintained our borrowing at approximately 90 percent of our gross loans. This has meant that we can leverage available shareholder funds at a ratio of 9 to 1.

Table 3 demonstrates that the increasing investment in FICB stock has limited the amount of funds we can loan.

Again, I might point out that from 1981 to 1985, our investment in the FICB stock rose from 5 million to 8 million, our own loans in funds shrunk from 10 million to 3 million, as our gross loan assets were shrinking from 94 million to 53 million, and the percent borrowed from FICB rose from 89 to 93.

PCA of Northern Ohio has already invested more in FICB stock than the amount invested in the PCA by its stockholders. Our investment in the FICB includes $609,000 in cash invested in 1985. The $8,017,000 investment is actually understated because $114,000 was written off in 1985 due to losses incurred by the FICB. Stock in the PCA of Northern Ohio held by our borrowers amounted to $4,534,000 as of December 31. So we don't have as many of our own funds in loans anymore as what we have stock held in our association.

At the rate we are going, all of our net worth will soon be tied up in FICB stock.

The increased investment in FICB stock reduces the amount of money available to loan to farmers. The effect is more than a dollar for dollar reduction because the amount we have invested in FICB stock reduces not only the amount of cash we have on hand but also reduces the amount we can borrow from the FICB. And if I might inject here, it also affects our ability to be forbearant because, actually, when you stop to think about it, given the direct loan limited formulas that we work under, the only money that we have to be forbearant within our PCA is our own funds and loans because the FICB will only fund the Class 1 and the half of the Class 2 loans.

The amount of our shareholders' own funds available to invest in loans and the leverage ratio, based upon borrowing limits, determines the amount of credit available to our stockholders. Any restriction on our ability to borrow from the FICB or any requirement that we increase our investment in FICB stock directly reduces the credit available to farmers in our lending territory. As things stand, the increase in the amount of money PCA of Northern Ohio has invested in FICB stock has reduced the available agricultural credit to our stockholders by $15 million in just the last four years. Unless we can change this trend, we will soon be unable to fund our existing borrowers.

Discriminatory treatment. We believe that what has happened and will happen to Amarillo PCA and to us is contrary to the will of Congress. We see a new attitude that the interests of the local PCAs and FIBAs are no longer important. In their latest financial statements, the FICBs and the FLBs consolidate PCA and FIBA as assets with their own. That is not the way Congress intended the System to operate.

The Farm Credit Act Amendments prohibit discrimination against non-merging PCAs, yet the FICB of Louisville is willing to provide assistance to the consolidated PCA in the Fourth District, using our investment to help fund the assistance.

And expenses. In addition to discriminatory treatment at the district level, layer upon layer of expensive administration is being added—the FCA, the FCCA, the FFCBFC, and the FSSCC. There are too many people trying to build bureaucratic empires on the backs of the farmers. Who will pay for it? In the long run these expenses will overburden the System. You may think that the PCAs can be prevented from leaving, but how can you retain the farmers and ranchers? If Amarillo PCA is able to reorganize, the FICBs will have to pay attention to their stockholders, just as we have to pay attention to ours. A reorganized Amarillo PCA will provide an incentive for the Farm Credit System to operate efficiently and with the interests of local PCAs in mind.

We are, therefore, in agreement with Amarillo PCA's proposal to reorganize. Unless Amarillo PCA is permitted to do so, it will soon find itself in the same squeeze we face, that is, it will find itself financing its FICB rather than the farmers and ranchers who depend upon it.

Mr. **Auberger**. Thank you.

Mr. **Edwards**. Mr. Biery, you commented at length on the impact of the PCAs' investment in the FICB. What would be the impact on your PCA if it lost its investment in the FICB in its entirety, simply had to write it off?

Mr. **Biery**. Right now the main impact on it would be on our debt-to-capital ratio. Our investment in our FICB is non-interest bearing. Actually, the only benefit we would receive from that other than our debt-to-capital ratio would be the fact that our FICB can loan money to us at a lower rate because they have that money there working for them.

Mr. **Edwards**. Would it not also impair the stock of your members?

Mr. **Biery**. If we lost our investment?

Mr. **Edwards**. Yes.

Mr. **Biery**. Well, it would if we have more invested in our FICB, if we have some of our members' stock invested there, yes. And that's exactly the situation we're facing.

Mr. **Edwards**. What would be the impact on your district if your FICB required assistance and it was unavailable?

Mr. **Biery**. What would be the impact on our district? Well, quite frankly, our district is pretty well capitalized right now, and it probably wouldn't happen in the near future.

Mr. **Edwards**. What would be the impact on your district if your Land Bank required assistance and it were not available?

Mr. **Biery**. That's a distinct possibility it is.

Mr. **Edwards**. And if it were not available?

Mr. **Biery**. Well, we would hope that this assistance, first of all, it's our belief that we should help those that are strong, and on a case-by-case basis possibly help those that need help. You know, all the time we have—we see co-ops in our communities fail and another co-op commence to help. We see farmers fail and other farmers come in to fill the void. It's tragic. We see banks fail in the commercial banking system. Some other bank comes in to fill the void.

Mr. **Edwards**. Your preference then would be to simply liquidate those institutions that are not solvent financially?

Mr. **Biery**. My preference would be to make it possible for the strong ones to continue to operate so that they can continue to make money for the System so that this System could continue to prosper.

Mr. **Edwards**. You have expressed a view in your statement in support of the OFI route as a viable alternative for Amarillo. Would that be a viable alternative for strong associations, say, in your district?

Mr. **Biery**. We don't know. We've tried that route last summer when we were unhappy with some things that were happening in our district. And I think, Mr. Edwards, you are familiar with that. We ran into trouble when the 611.1145 regulations were passed in September. In effect, we had no collateral anymore. We, too, as I pointed out here, have signed a loss sharing agreement.

As far as a viable alternative is concerned, we want to stay in the System if we can. If our back gets pushed against the wall as flat as possible and the noose starts to get tightened we will look for all the other alternatives and will make contingency plans, as we have done with the Ohio General Assembly.

Mr. **Edwards**. When the 1980 Amendments to the Act were passed they broadened substantially the rights of OFIs, particularly commercial bank affiliated OFIs to have access to the System. Those amendments were generally opposed, and vigorously, by PCAs nationally, including those in the Fourth District. How do you account for the change in view of the OFI authority?

Mr. **Biery**. You mean in the change in my view or——

Mr. **Edwards**. Yes.

Mr. **Biery** [continuing]. Our view?

Mr. **Edwards**. Yes.

Mr. **Biery**. I don't think that I said that I'd changed our views. I think I said that we would prefer to stay in the System, work within the System. But the OFI, there is an OFI in existence in our area, Producers' Livestock Association. It works. There they can do better than we can. The last couple years their interest rate is—remembering that we're usually the lowest interest rate in the district at the Northern Ohio PCA—the Producers' Livestock is usually a half a percent higher than we are. They have no stock requirements. So an effective interest rate there they do a half a percent better job than we do. And in these times when farmers are facing a difficult task and trying to survive, I don't know whether I could advise a farmer to come to PCA when he can get a loan to buy his cattle or his feeder pigs or some livestock equipment from Producers' Livestock at a lower interest rate.

Usually loyalty ends in our area at about a half a percent.

Mr. **Medero**. Mr. Biery, referring to Mr. Edwards' comments about the OFIs, back in 1980, OFI was a dirty term around the Farm Credit System. Nobody wanted them and nobody would deal with them and nobody wanted to let them in the club.

Mr. **Biery**. Quite frankly, sir, I don't know whether I even understood what it meant.

Mr. **Medero**. In any event, the arguments that were made and that were made by the Louisville District was that the OFIs wanted to be in the System and wanted to participate in the System when it was to their advantage, and when interest rates went down and their interest costs went down they wanted to get out of the System and leave everybody else in the System where they were and abandon the System.

Two questions. Isn't this exactly what Amarillo and it sounds like you are advocating at this time now that the Farm Credit System is facing adversity? And second, if OFIs are now reborn again and they are the thing to be, should the Farm Credit System not open its doors to all OFIs and act as a discounter on an open and free basis to all OFIs, both at the Land Bank level and at the PCA level to assure that farmers have adequate and an ample supply of credit?

Mr. **Biery**. That's the thing we're trying to do in our association to ensure that the farmers have an adequate and ample supply of credit, whatever means that we have to follow to do that. I've stated already what our preferences are. But we will have to take some actions if we can't continue to survive with the present System the way it is.

I get some impressions that our district bank people are also frustrated. Quite frankly, their hands are tied about that 14.4 capitalization requirement because of the Capital Directive Number 1 that was sent out by Governor Wilkinson in mid-February. They couldn't help us by retiring any stock to make us more competitive if they had to, right now. To my knowledge, the regulations passed last fall haven't been rescinded. They are still in effect, so.

Mr. **Medero**. We have had the opportunity to argue some of the legal issues that we're talking about over the past. Is it fair to say that you have explored extensively the possibility of leaving the System, and that if the opportunity presented itself you, within a reasonably short period of time, would be able to take advantage of Amarillo's withdrawal from the System if you found it to be in your advantage?

Mr. **Biery**. We were a lot more eager to leave the System a year ago than we are now, sir. And we have, yes, explored the possibilities to the tune of obtaining financing. But we haven't explored any of the possibilities as far as the procedure for doing that, such as the Montana Livestock or the Amarillo PCA.

Mr. **Medero**. Thank you.

Mr. **Auberger**. Okay. Thank you, Mr. Biery. I have no questions.

Mr. **Biery**. Thank you.

Mr. **Auberger**. The next witness is Richard Dean who is a director of the Midland PCA.

Welcome, sir.

STATEMENT OF RICHARD DEAN, DIRECTOR OF THE BOARD OF THE MIDLAND PCA, OMAHA, NEBRASKA

Mr. **Dean**. Thank you. I am Richard Dean, a farmer from Mason City, Iowa, and a director of the Production Credit Association of the Midlands in the Omaha District.

TESTIMONY OF DEAN BIERY, PCA OF NORTHERN OHIO

I am Dean Biery, a director of Production Credit Association of Northern Ohio I am here for our board of directors to suppport the efforts of Amarillo Production Credit Association to reorganize in the interest of continued service to its stockholders. Speaking for our stockholders, we think that Amarillo Production Credit Association's request should be granted for the following reasons:

1. Local ownership and control of PCAs must be preserved;
2. Threatened transfers of assets and equities by the Farm Credit Administration will destroy the base of good customers needed to operate a safe and sound PCA; and
3. The value of any PCA's investment in Federal Intermediate Credit Bank stock is threatened by the FCA's regulations and Farm Credit Amendments Act of 1985.

At the outset, we want it clearly understood that we agree with Amarillo PCA that because it is reorganizing rather than dissolving or liquidating no FCA approval is required. Even so, we understand the reasons Amarillo PCA is cooperating with FCA requests for information. We have also tried to be as cooperative as possible, even though we have also found it necessary to sue the FCA.

There are several organizations that claim to speak for the good of the Farm Credit System, including the FCA, the FCCA, the Farm Credit Council, the Federal Farm Credit Banks Funding Corporation, and the Farm Credit System Capital Corporation, but they don't speak for our farmers.

To understand why Amarillo PCA needs to reorganize you have to understand that they are not alone in having to protect themselves against FCA transfers of their net worth. The trend toward more centralization of control over the assets and net worth of PCAs all over the country threatens to destroy any control local farmers and ranchers have over their PCAs.

We find ourselves in the same position as Amarillo PCA. After having worked for fifty years to build our PCA and help the farmers who depend on us we face the loss of everything we have built. Most of our farmers have from $2,000 to $5,000 invested in the stock of our PCA. If our assets are taken, it won't matter that we still have the formalities of a local charter. These farmers will have lost what has been built up over 50 years. We are considering reorganizing into a credit union if necessary to protect our stockholders. Recently, the Ohio House of Representatives passed by a 95-1 vote a bill that would allow us to do so.

Unless Amarillo PCA is able to reorganize, it will eventually face the same situation we face, that is, it will be weakened by the FCA in an effort to strengthen other associations. Those other associations need help from outside the Farm Credit System. In the meantime, well run PCAs must be allowed to continue their successful operations. In that way the Farm Credit System can retain the good credit that can restore it to health. Unless Amarillo PCA can reorgnize, it will eventually lose its better credit risks and start to deteriorate. If it can reorganize, it will be able to retain these farmers and ranchers and participate in the System as an Other Financing Institution, or "OFI." The Farm Credit System will be better off with a healthy OFI than a defunct PCA.

Amarillo PCA's future can best be understood by looking at our PCA's past. In the thirty-five year period from 1950 to June 30, 1985, PCA of Northern Ohio loaned more than $1 billion. It had less than $1 million in cumulative loan losses from the date it was chartered in 1934 until June 30, 1985. The association, under local control, has been and continues to be profitable despite what many regard as the most adverse agricultural conditions in fifty years. It has been and is the largest agricultural lender within the six-county area which it operates. There are two reasons for our success. First, our stockholders have had a great deal of confidence in the strength of PCA. When they borrow money they are required to invest an amount equal to eight percent of the loan and to maintain their investment at that ratio during the life of the loan. They have always been confident that this investment can and will be returned to them as the loan is paid. Second, the PCA has historically loaned money at very favorable rates, typically as low as any production credit association in the Fourth Farm Credit District, comprising Ohio, Indiana, Kentucky and Tennessee.

These same two factors, confidence and low interest rates, combined to give both Amarillo PCA and PCA of Northern Ohio a very significant market advantage over competing lenders. As a result, both associations have been able to attract the best of the agricultural credit risks and to enable their stockholders to reduce interest expenses, which results in a lower overall operating cost, further helping these stockholders to operate successfully in a difficult economic period. In turn, this has enabled both PCAs to operate with minimal credit losses, which, of course lowers operating costs.

We don't claim all of the credit for the success of our stockholders, but under local control we have helped them be successful. It is a partnership that has benefited everyone, especially the Farm Credit System. In 1981–1985 we paid $637,000 in net loss sharing, $41 million in interest to the FICB, and invested $3,700,000 in stock of the FICB. Yet we are not facing the same decision as Amarillo PCA, not because we want to, but because we have to. Here is why. First, we face the same threat that under FCA regulations and the Farm Credit Amendments Act of 1985 our assets and net worth will be taken from us. Second, we face the prospect that our investment in FICB stock, an investment that is already much more than we can afford, will be worth less because the FICB will suffer a net worth transfer. Even without such a transfer, we wrote off $114,000 on our FICB investment in 1985. Third, the amount we are able to lend is being severely restricted because of the amount of money we have invested in FICB stock. Forth, we are faced with possibly discriminatory treatment. Fifth, the System's expenses are going to go out of control.

The threat to the net worth of PCA's. Recently, as agricultural conditions in the United States deteriorated, the quality of the agricultural debt began to be called into question. Sixty-eight commercial banks with significant amounts of agricultural loans in their portfolios were closed in 1985, up from 32 in 1984. In mid-1985 the Farm Credit Administration revealed similar problems in agricultural debt held by the farm Credit System lenders. As a result, negative accounts in the news media began to mention Farm Credit System securities. The yield differential between U.S. Treasury securities and those of the Farm Credit System, which had been almost insignificant, rose to about one-fifth of a percentage point.

A Farm Credit Administration regulation that was designed to calm the credit markets has had the opposite effect. The regulation purports to give the Farm Credit Administration the authority to transfer assets and equities among Farm Credit System leaders. Immediately after it was adopted, the interest rates on Farm Credit System securities increased from about one-fifth of a percentage point over the yield on comparable U.S. Treasury securities to about nine-tenths of a percentage point over Treasuries. According to accounts in the press, the market feared that the regulation would drive the better credit risks out of the farm Credit System. The yield differential is not about two-fifths of a percentage point, still double that of last summer.

The Farm Credit Banks generally opposed the regulation. Amarillo PCA filed suit in federal court to have it set aside. So did we. In the meantime, however, the Farm Credit Amendments Act provides a new threat in the form of the Farm Credit System Capital Corporation. The Farm Credit System Capital Corporation will increase our costs and reduce the amount we can lend to farmers. That means that we will be less profitable and that the System will receive less income from us.

Overinvestment in FICB stock. Our investment in FICB stock has increased by about 60 percent in four years. The amount we have been required to invest in FICB of Louisville exceeds what other Intermediate Credit Banks require their PCAs to invest. Table 1 compares the Class B stock of the FICBs with their total assets. FICB of Louisville has a capital ratio more than three times that of FICB of Texas. If Amarillo PCA does not reorganize it can expect to face increasing investment requirements. This will result in both a greater investment in nonearning assets than they can afford and less money available for lending to farmers and ranchers.

TABLE 1

[In thousands of dollars]

FICB	Class B stock-PCA's	Total assets	Percentages
Springfield	42,209	665,417	6.34
Baltimore	50,477	847,082	5.96
Columbia	172,779	1,540,279	11.22
Louisville	199,213	1,383,247	14.40
Jackson	67,826	664,473	10.21
St. Louis	103,388	1,017,800	10.16
St. Paul	201,574	2,753,065	7.32
Omaha	135,681	1,415,524	9.59
Wichita	97,226	983,078	9.89

TABLE 1—Continued

[In thousands of dollars]

FICB	Class B stock-PCA's	Total assets	Percentages
Texas	57,557	1,416,208	4.06
Sacramento	147,251	2,925,260	5.03
Spokane	66,075	849,365	7.78
Aggregate	1,341,253	16,449,110	8.15

Source—Summary Report of Condition and Performance of the Farm Credit System, Quarter Ending December 31, 1985.

Table 2 shows the increasing amount of our net worth invested in FICB stock.

TABLE 2

[In thousands of dollars]

	Net worth of PCA of northern Ohio	Investment in FICB	Percent
1981	$13,124	$5,008	38
1982	13,096	5,823	44
1983	12,409	6,643	54
1984	12,757	7,522	59
1985	11,215	8,017	71

The increased investment in FICB stock effectively costs us about $300,000 per year, which we have to pass along to the farmers as about six tenths of a percent additional interest. This costs our average stockholder about $300 per year in additional interest. The increased investment is also one of the reasons our loan portfolio has shrunk by more than 40 percent in the last last four years, to the point where we now have more of our funds invested in the FICB than in loans to farmers.

Restrictions on lending. Under Section 614.4190 of the FCA's regulations our ability to borrow directly from the FICB is limited. The net result is that in our particular case we could borrow approximately 95 percent of our loan portfolio. In recent years we have maintained our borrowing at approximately 90 percent of our gross loans. This has meant that we can leverage available shareholder funds at a ratio of about 9:1. Table 3 demonstrates that the increasing investment in FICB stock has limited the amount of funds we can loan.

TABLE 3

[In thousands of dollars]

	PCA funds in FICB stock	PCA funds in loans	Gross loan assets	Borrowing from FICB	Percent borrowed
1981	$5,008	$10,153	$94,186	$83,825	89
1982	5,823	9,198	88,479	79,281	90
1983	6,643	7,218	73,236	66,018	90
1984	7,522	6,894	73,925	67,031	91
1985	8,017	3,786	53,538	49,752	93

PCA of Northern Ohio has already invested more in FICB stock than the amount invested in the PCA by its stockholders. Our investment in the FICB includes $609,000 in cash invested in 1985. The $8,017,000 investment is actually understated because $114,000 was written off in 1985 due to losses incurred by the FICB. Stock in PCA of Northern Ohio held by our borrowers amounted to $4,534,000 as of December 31, 1985. At the rate we are going, all of our net worth will soon be tied up in FICB stock.

The increased investment in FICB stock reduces the amount of money available to loan to farmers. The effect is more than a dollar for dollar reduction because the amount we have invested in FICB stock reduces not only the amount of cash we have on hand but also reduce the amount we can borrow from the FICB. The amount of our shareholders' own funds available to invest in loans and the leverage ratio (based upon borrowing limits) determines the amount of credit available to our stockholders. Any restriction on our ability to borrow from the FICB or any requirement that we increase our investment in FICB stock directly reduces the credit available to farmers in our lending territory. As things stand, the increase in the amount of money PCA of Northern Ohio has invested in FICB stock has reduced the available agricultural credit to our stockholders by $15 million in just the last four years. Unless we can change this trend, we will soon be unable to fund our existing borrowers.

Discriminatory treatment. We believe that what has happened and will happen to Amarillo PCA and to us is contrary to the will of Congress. We see a new attitude that the interests of the local PCAs and FLBAs are no longer important. In their latest financial statements, the FICBs and FLBs consolidate PCA and FLBA assets with their own. That is not the way Congress intended the System to operate. The Farm Credit Act Amendments prohibit discrimination against nonmerging PCAs, yet the FICB of Louisville is willing to provide assistance to the consolidated PCA in the Fourth District, using our investment to help fund the assistance.

Expenses. In addition to discriminatory treatment at the district level, layer upon layer of expensive administration is being added, the FCA, the FCCA, the FFCBFC, and the FSSCC. There are too many people trying to build bureaucratic empires on the backs of the farmers. Who will pay for it? In the long run these expenses will overburden the System. You may think that the PCAs can be prevented from leaving, but how can you retain the farmers and ranchers? If Amarillo PCA is able to reorganize, the FICBs will have to pay attention to their stockholders, just as we have to pay attention to ours. A reorganized Amarillo PCA will provide an incentive for the Farm Credit System to operate efficiently and with the interests of local PCAs in mind.

We are therefore in agreement with Amarillo PCA's proposal to reorganize. Unless Amarillo PCA is permitted to do so, it will soon find itself in the same squeeze we face, that is, it will find itself financing its FICB rather than the farmers and ranchers who depend upon it.

MARCH 26, 1987 HEARING

STATEMENT OF HON. HENRY BELLMON, GOVERNOR, STATE OF OKLAHOMA

Mr. Chairman, Members of the Committee, it is an honor to be invited to testify regarding the United States' farm problem and the Farm Credit System. I realize much has been said on these matters over the years but, apparently, so far a solution to the problem has been elusive. Perhaps as an active farmer and a government official, I can offer some helpful suggestions.

Last year, American consumers experienced 2.9% car loans, 8.5-9.5% mortgage rates, and even some decline in credit card rates. American business also shared in the good news on interest with a 7.5% prime lending rate. However, if your business happened to be agriculture, and you were unfortunate enough to be indebted to the Farm Credit System, and you were able to afford the payments, you would have paid over 12%, almost 13%, interest on your farm loan.

The Farm Credit System has recently reduced its rates slightly. This is not enough; somehow debt service on farm loans must be reduced to market level. For every 1% extra the system charges, American farmers pay $580 million annually in unnecessary interest. Last year commercial farm lenders charged 9.5%. If Farm Credit had charged market rates of interest, American farmers would have saved $1.5 billion. Attempting to offset past financial misjudgments by charging today's farmer $1.5 billion in extra interest is not the way to improve our competitiveness with foreign agriculture. In this age of federal budget deficits, pouring huge amounts into farm programs with one hand while the Farm Credit System takes it back with the other, does not make sense.

Mr. Chairman, let me track for you what frequently happens. A farmer finds it impossible to service his debt to the Federal Land Bank. The Federal Land Bank then either takes a title to the farm in lieu of foreclosure or in some cases proceeds through the courts to foreclose on the land. The land is then turned over to the Capital Corporation or is auctioned off.

If the land is auctioned, normally the price received will be well below the face amount of the loan causing the Federal Land Bank to take an immediate and serious loss.

Frequently, the new buyer will be given a preferential interest rate by the Federal Land Bank and since the purchase cost is low, the new buyer has a chance of handling the debt service.

There are three unfortunate results of the above policy:

1. A farm family has been put out of a livelihood and out of a home, and in many cases will need social services including welfare. In addition, a rural community is further depopulated.
2. The Federal Land Bank has taken a serious loss on its balance sheet. In addition, collateral supporting other loans loses value.
3. The local commercial bank which held the operating loan now owns a set of farm machinery which has little value.

Mr. Chairman, I believe there is a way to avoid these bad results. What I propose is this:

1. Farm families that are still on the land have survived seven years of back to back hardship. Most of them are efficient and stalwart producers who can probably handle the land as well as anyone. They have survived an intensive selection process which has had the effect of eliminating the inefficient and the plungers.
2. No farmer or rancher forced the Federal Land Bank to make the existing loans. These loans were entered into between a willing borrower and a willing lender. In effect, farmers and the Federal Land Bank became partners when the loans were made. It is my feeling that they should remain partners rather than both taking serious losses that are resulting from the present arrangement.

Here is what I believe should be done. The Federal Land Bank should be allowed to make "debt for equity swaps" and take an undivided ownership in the land in cases where farmers or ranchers find it impossible to handle their debt service. The amount of the ownership could vary up to 90%, if need be, leaving the present owner in possession of a share of the ownership but in a position to continue living on the property and managing the land as part owner/part tenant.

The farmer would continue to pay interest on the amount of ownership retained and would pay the Federal Land Bank cash rent on the portion owned by the bank. The cash rent would be figured at Treasury costs of money on the face value of the loan.

The farmer would be given an option to repurchase the Federal Land Bank's share during the time period between five and ten years out. At the expiration of the ten-year period, or at a time mutually agreed to prior to that, the land could be sold and the profits be distributed according to the agreement. The Federal Land Bank would accrue charges against its share of land at the rate reflecting Federal Land Bank costs of funds. This amount would be recovered when the land was sold or when the present owner repurchased the Federal Land Bank interest.

Attached is a series of tables indicating the financial consequences of this arrangement. They show dramatic reduction in annual debt costs to the farmer. The financial health of the Federal Land Bank would not be impaired since it would now own assets in place of debt.

The benefits of this approach are many:

1. It would leave the farm family on the land and avoid the social consequences of another major rural migration into our cities.
2. It would prevent the Federal Land Bank from taking sudden large losses on its balance sheet and avoid the necessity of a multi-billion dollar bailout by the U.S. Treasury.
3. It would provide lower annual land costs to farmers giving them a chance to survive until the farm economy improves.
4. The commercial banks which, in many cases, have made operating loans to farmers would avoid the necessity of liquidating farm equipment and the loss which that entails.
5. The rapid decline in farm land values due in part to excessive sales of foreclosed lands would be slowed or halted.

Mr. Chairman, when the Farm Credit Administration undertakes to "restructure" loans, a great problem arises. When a deserving farmer's loan is "written down", the word rapidly spreads and other farmers, many of whom can service their debt, demand comparable treatment. This is understandable. In order for the system to help on a selective basis, an element of "pain" needs to be introduced. The proposal I have outlined provides a deterrent to borrowers who can handle their debt since to participate means giving up ownership. Later repurchase would necessitate payment of deferred interest.

The more land the Federal Land Bank acquires and offers for sale, the more rapidly land values fall. When farmers lose their land they no longer can pay for their equipment so commercial banks are rapidly liquidating farm machinery. In Oklahoma, 49 banks have already failed and most of these were heavily involved in agricultural lending. Since January 1st, 11 Oklahoma banks have failed (an average of one per week).

The proposal I have made would help stabilize the economy of farmbelt states and give the Federal Credit System the chance to survive and be of assistance to future generations of farmers. The System has served agriculture well in the past and will be greatly needed in future years when the growing world population will again demand maximum production from U.S. agriculture.

Mr. Chairman, changes need to be made in the structure of the Farm Credit System. For those who have attempted to work with the Federal Land Banks to resolve the current problems, it is obvious that at the present time no one is in charge. The Congress has created a policing system through the establishment of the Federal Credit Administration. Also, the Capital Corporation provides a means for managing acquired assets but there is no "Chief Executive Officer" of the system to make affirmative policy and to provide the leadership which the system and American agriculture desperately needs.

As Members know, many suggestions have been made regarding the creation of a "AGGIE MAE" to help provide a secondary market for farm loans. This would seem to be a worthy objective but attention also needs to be given to the leadership structure of the Farm Credit System as well as reducing annual land costs to operators, many of whom are facing immediate removal from their farms and ranches.

Mr. Chairman, it is unrealistic to believe that agriculture can operate without credit. Unless we plan to populate the countryside with literally millions of peasants who would be content to eke out a meager existence with muscle power and primitive tools, there is no way to avoid the necessity of farmers borrowing money to acquire land and equipment and to pay operating costs. It is wrong to believe that the present farm situation will right itself without changes in the agricultural credit policy. The country is headed in the direction of absentee landlords who purchase farms at well below their productive value.

Mr. Chairman, stabilizing the Farm Credit System is a worthy objective and deserves the full attention of this Committee and the Congress. At the same time, it is wrong to believe that dealing with credit needs is going to permanently solve the

United States' agricultural problem. The fact is that commodity prices, especially grain prices, are now so low that even with the generous subsidies which Congress is providing, efficient farmers with modest debt loads cannot long survive. Efforts need to be taken to bring commodity prices more in line with costs of production. Worldwide, over half the human population earns its livelihood from the land. Community prices below cost of production is spreading rural poverty across the entire globe.

The fact is at the present time the world is producing slightly more grain than it can utilize. The United States has undertaken to unilaterally balance world food supply and demand. This has placed an enormous burden on the United States' agri-business industry and the United States taxpayers.

Mr. Chairman, I believe the time has come for the United States to lead the way in the establishment of an international grain agreement. The objective would be to achieve participation by other grain exporting nations in multilateral restraints on grain production until supply and demand were more nearly balanced. The cost is too great for the United States agri-business and the United States Treasury to shoulder alone.

At the present time, many countries, including the United States, are offering export subsidies which have the effect of reducing grain prices even further. This is helping to impoverish food producers worldwide. Impoverished farmers cannot affort the inputs necessary to sustain production or to protect their land. Neither can they afford to purchase factory ouputs or educate their families.

Mr. Chairman, this hearing is basically about the problems with the Farm Credit System but its problem cannot be dealt with in isolation. In striving for a solution, I strongly urge the Subcommittee to look at the overall problems of agriculture and seek to provide not only credit but a stable and fair price structure. A structure that will allow a decent standard of living in the rural areas of the world and assure that farm families have the resources needed to care for their families, protect their soil and continue to provide the abundance of food and fiber which the world has long taken for granted.

[Governor Bellmon's Proposal to Restructure Federal Land Bank Farm Debt follows:]

20-Mar-87 GOVERNOR BELLMON PROPOSAL TO RESTRUCTURE FEDERAL LAND BANK FARM DEBT

SIMPLIFIED ANALYSIS OF LOAN RESTRUCTURE WITH AN UNDIVIDED INTEREST TRANSFERED TO THE FEDERAL LAND BANK WITH A REPURCHASE OPTION

	NOTE PRINCIPAL BALANCE	CURRENT INTEREST RATE	RESTRUCTURED CURRENT INTEREST RATE	RESTRUCTURED ACCRUAL INTEREST RATE
FACE AMOUNT OF LOAN:	$100,000	13.75%	10.38%	11.88%
UNDIVIDED INTEREST ASSIGNED	50.00% ASSIGNED TO FEDERAL LAND BANK			
PRINCIPAL OWED BY DEBTOR	$50,000		13.75%	13.75%
VALUE ASSIGNED TO FLB	$50,000		7.00%	10.00%
ANNUAL CASH RENT	7.00% CREDITED TO ACCRUED INTEREST DUE THE FEDERAL LAND BANK.			

EFFECT ON DEBTOR CASH FLOW

YEAR	INTEREST COST BEFORE RESTRUCTURE	INTEREST COST AFTER RESTRUCTURE	ANNUAL RENT AT 7.00%	TOTAL CURRENT COST TO DEBTOR	REDUCTION IN CURRENT COST TO DEBTOR
1	$13,750	$6,875	$3,500	$10,375	($3,375)
2	$13,750	$6,875	$3,500	$10,375	($3,375)
3	$13,750	$6,875	$3,500	$10,375	($3,375)
4	$13,750	$6,875	$3,500	$10,375	($3,375)
5	$13,750	$6,875	$3,500	$10,375	($3,375)
6	$13,750	$6,875	$3,500	$10,375	($3,375)
7	$13,750	$6,875	$3,500	$10,375	($3,375)
8	$13,750	$6,875	$3,500	$10,375	($3,375)
9	$13,750	$6,875	$3,500	$10,375	($3,375)
10	$13,750	$6,875	$3,500	$10,375	($3,375)

ACCRUED INTEREST ON UNDIVIDED INTEREST TRANSFERED TO THE FEDERAL LAND BANK

	NO EFFECT ON CURRENT CASH FLOW			
YEAR	INTEREST ACCRUED	LESS RENTAL CREDIT	NET INTEREST ACCRUED	BUYOUT COST TO DEBTOR FOR FLB UNDIVIDED INTEREST
1	$5,000	($3,500)	$1,500	$51,500
2	$5,000	($3,500)	$1,500	$53,000
3	$5,000	($3,500)	$1,500	$54,500
4	$5,000	($3,500)	$1,500	$56,000
5	$5,000	($3,500)	$1,500	$57,500
6	$5,000	($3,500)	$1,500	$59,000
7	$5,000	($3,500)	$1,500	$60,500
8	$5,000	($3,500)	$1,500	$62,000
9	$5,000	($3,500)	$1,500	$63,500
10	$5,000	($3,500)	$1,500	$65,000

20-Mar-87

GOVERNOR BELLMON PROPOSAL TO RESTRUCTURE FEDERAL LAND BANK FARM DEBT

SIMPLIFIED ANALYSIS OF LOAN RESTRUCTURE
WITH AN UNDIVIDED INTEREST TRANSFERED TO
THE FEDERAL LAND BANK WITH A REPURCHASE OPTION

	NOTE PRINCIPAL BALANCE	CURRENT INTEREST RATE	RESTRUCTURED CURRENT INTEREST RATE	RESTRUCTURED ACCRUAL INTEREST RATE
FACE AMOUNT OF LOAN:	$100,000	13.75%	10.38%	11.88%
UNDIVIDED INTEREST ASSIGNED	50.00% ASSIGNED TO FEDERAL LAND BANK			
PRINCIPAL OWED BY DEBTOR	$50,000		13.75%	13.75%
VALUE ASSIGNED TO FLB	$50,000		7.00%	10.00%
ANNUAL CASH RENT	7.00% CREDITED TO ACCRUED INTEREST DUE THE FEDERAL LAND BANK.			

PROCEEDS TO FEDERAL LAND BANK INCLUDING BUYOUT COST TO DEBTOR

YEAR	CURRENT INTEREST PAID	CURRENT RENT PAID	TOTAL CURRENT PAYMENTS	BUYOUT COST TO DEBTOR FOR FLB UNDIVIDED INTEREST AND RETAINED INTEREST	TOTAL PROCEEDS TO FEDERAL LAND BANK
1	$6,875	$3,500	$10,375	$101,500	$111,875
2	$6,875	$3,500	$10,375	$103,000	$113,375
3	$6,875	$3,500	$10,375	$104,500	$114,875
4	$6,875	$3,500	$10,375	$106,000	$116,375
5	$6,875	$3,500	$10,375	$107,500	$117,875
6	$6,875	$3,500	$10,375	$109,000	$119,375
7	$6,875	$3,500	$10,375	$110,500	$120,875
8	$6,875	$3,500	$10,375	$112,000	$122,375
9	$6,875	$3,500	$10,375	$113,500	$123,875
10	$6,875	$3,500	$10,375	$115,000	$125,375

20-Mar-87 GOVERNOR BELLMON PROPOSAL TO RESTRUCTURE FEDERAL LAND BANK FARM DEBT

SIMPLIFIED ANALYSIS OF LOAN RESTRUCTURE WITH AN UNDIVIDED INTEREST TRANSFERED TO THE FEDERAL LAND BANK WITH A REPURCHASE OPTION

	NOTE PRINCIPAL BALANCE	CURRENT INTEREST RATE	RESTRUCTURED CURRENT INTEREST RATE	RESTRUCTURED ACCRUAL INTEREST RATE
FACE AMOUNT OF LOAN:	$100,000	13.75%	9.03%	11.13%
UNDIVIDED INTEREST ASSIGNED	70.00% ASSIGNED TO FEDERAL LAND BANK			
PRINCIPAL OWED BY DEBTOR	$30,000		13.75%	13.75%
VALUE ASSIGNED TO FLB	$70,000		7.00%	10.00%
ANNUAL CASH RENT	7.00% CREDITED TO ACCRUED INTEREST DUE THE FEDERAL LAND BANK.			

EFFECT ON DEBTOR CASH FLOW

YEAR	INTEREST COST BEFORE RESTRUCTURE	INTEREST COST AFTER RESTRUCTURE	ANNUAL RENT AT 7.00%	TOTAL CURRENT COST TO DEBTOR	REDUCTION IN CURRENT COST TO DEBTOR
1	$13,750	$4,125	$4,900	$9,025	($4,725)
2	$13,750	$4,125	$4,900	$9,025	($4,725)
3	$13,750	$4,125	$4,900	$9,025	($4,725)
4	$13,750	$4,125	$4,900	$9,025	($4,725)
5	$13,750	$4,125	$4,900	$9,025	($4,725)
6	$13,750	$4,125	$4,900	$9,025	($4,725)
7	$13,750	$4,125	$4,900	$9,025	($4,725)
8	$13,750	$4,125	$4,900	$9,025	($4,725)
9	$13,750	$4,125	$4,900	$9,025	($4,725)
10	$13,750	$4,125	$4,900	$9,025	($4,725)

ACCRUED INTEREST ON UNDIVIDED INTEREST TRANSFERED TO THE FEDERAL LAND BANK

	NO EFFECT ON CURRENT CASH FLOW			
YEAR	INTEREST ACCRUED	LESS RENTAL CREDIT	NET INTEREST ACCRUED	BUYOUT COST TO DEBTOR FOR FLB UNDIVIDED INTEREST
1	$7,000	($4,900)	$2,100	$72,100
2	$7,000	($4,900)	$2,100	$74,200
3	$7,000	($4,900)	$2,100	$76,300
4	$7,000	($4,900)	$2,100	$78,400
5	$7,000	($4,900)	$2,100	$80,500
6	$7,000	($4,900)	$2,100	$82,600
7	$7,000	($4,900)	$2,100	$84,700
8	$7,000	($4,900)	$2,100	$86,800
9	$7,000	($4,900)	$2,100	$88,900
10	$7,000	($4,900)	$2,100	$91,000

20-Mar-87 GOVERNOR BELLMON PROPOSAL TO RESTRUCTURE FEDERAL LAND BANK FARM DEBT

SIMPLIFIED ANALYSIS OF LOAN RESTRUCTURE WITH AN UNDIVIDED INTEREST TRANSFERED TO THE FEDERAL LAND BANK WITH A REPURCHASE OPTION

	NOTE PRINCIPAL BALANCE	CURRENT INTEREST RATE	RESTRUCTURED CURRENT INTEREST RATE	RESTRUCTURED ACCRUAL INTEREST RATE
FACE AMOUNT OF LOAN:	$100,000	13.75%	9.03%	11.13%
UNDIVIDED INTEREST ASSIGNED	70.00% ASSIGNED TO FEDERAL LAND BANK			
PRINCIPAL OWED BY DEBTOR	$30,000		13.75%	13.75%
VALUE ASSIGNED TO FLB	$70,000		7.00%	10.00%

ANNUAL CASH RENT 7.00% CREDITED TO ACCRUED INTEREST DUE THE FEDERAL LAND BANK.

PROCEEDS TO FEDERAL LAND BANK INCLUDING BUYOUT COST TO DEBTOR

YEAR	CURRENT INTEREST PAID	CURRENT RENT PAID	TOTAL CURRENT PAYMENTS	BUYOUT COST TO DEBTOR FOR FLB UNDIVIDED INTEREST AND RETAINED INTEREST	TOTAL PROCEEDS TO FEDERAL LAND BANK
1	$4,125	$4,900	$9,025	$102,100	$111,125
2	$4,125	$4,900	$9,025	$104,200	$113,225
3	$4,125	$4,900	$9,025	$106,300	$115,325
4	$4,125	$4,900	$9,025	$108,400	$117,425
5	$4,125	$4,900	$9,025	$110,500	$119,525
6	$4,125	$4,900	$9,025	$112,600	$121,625
7	$4,125	$4,900	$9,025	$114,700	$123,725
8	$4,125	$4,900	$9,025	$116,800	$125,825
9	$4,125	$4,900	$9,025	$118,900	$127,925
10	$4,125	$4,900	$9,025	$121,000	$130,025

[illegible] GOVERNOR SULLIVAN PROPOSAL TO RESTRUCTURE FEDERAL LAND BANK FARM DEBT

SIMPLIFIED ANALYSIS OF LOAN RESTRUCTURE
WITH AN UNDIVIDED INTEREST TRANSFERRED TO
THE FEDERAL LAND BANK WITH A REPURCHASE OPTION.

	NOTE PRINCIPAL BALANCE	CURRENT INTEREST RATE	RESTRUCTURED CURRENT INTEREST RATE	RESTRUCTURED ACCRUAL INTEREST RATE
FACE AMOUNT OF LOAN	$100,000	13.75%	7.68%	10.38%
UNDIVIDED INTEREST ASSIGNED	90.00% ASSIGNED TO FEDERAL LAND BANK			
PRINCIPAL OWED BY DEBTOR	$10,000		13.75%	13.75%
VALUE ASSIGNED TO FLB	$90,000		7.00%	10.00%
ANNUAL CASH RENT	7.00% CREDITED TO ACCRUED INTEREST DUE THE FEDERAL LAND BANK.			

EFFECT ON DEBTOR CASH FLOW

YEAR	INTEREST COST BEFORE RESTRUCTURE	INTEREST COST AFTER RESTRUCTURE	ANNUAL RENT AT 7.00%	TOTAL CURRENT COST TO DEBTOR	REDUCTION IN CURRENT COST TO DEBTOR
1	$13,750	$1,375	$6,300	$7,675	($6,075)
2	$13,750	$1,375	$6,300	$7,675	($6,075)
3	$13,750	$1,375	$6,300	$7,675	($6,075)
4	$13,750	$1,375	$6,300	$7,675	($6,075)
5	$13,750	$1,375	$6,300	$7,675	($6,075)
6	$13,750	$1,375	$6,300	$7,675	($6,075)
7	$13,750	$1,375	$6,300	$7,675	($6,075)
8	$13,750	$1,375	$6,300	$7,675	($6,075)
9	$13,750	$1,375	$6,300	$7,675	($6,075)
10	$13,750	$1,375	$6,300	$7,675	($6,075)

ACCRUED INTEREST ON UNDIVIDED INTEREST TRANSFERED TO THE FEDERAL LAND BANK

	NO EFFECT ON CURRENT CASH FLOW			
YEAR	INTEREST ACCRUED	LESS RENTAL CREDIT	NET INTEREST ACCRUED	BUYOUT COST TO DEBTOR FOR FLB UNDIVIDED INTEREST
1	$9,000	($6,300)	$2,700	$92,700
2	$9,000	($6,300)	$2,700	$95,400
3	$9,000	($6,300)	$2,700	$98,100
4	$9,000	($6,300)	$2,700	$100,800
5	$9,000	($6,300)	$2,700	$103,500
6	$9,000	($6,300)	$2,700	$106,200
7	$9,000	($6,300)	$2,700	$108,900
8	$9,000	($6,300)	$2,700	$111,600
9	$9,000	($6,300)	$2,700	$114,300
10	$9,000	($6,300)	$2,700	$117,000

20-Mar-87 GOVERNOR BELLMON PROPOSAL TO RESTRUCTURE FEDERAL LAND BANK FARM DEBT

SIMPLIFIED ANALYSIS OF LOAN RESTRUCTURE
WITH AN UNDIVIDED INTEREST TRANSFERED TO
THE FEDERAL LAND BANK WITH A REPURCHASE OPTION

	NOTE PRINCIPAL BALANCE	CURRENT INTEREST RATE	RESTRUCTURED CURRENT INTEREST RATE	RESTRUCTURED ACCRUAL INTEREST RATE
FACE AMOUNT OF LOAN:	$100,000	13.75%	7.68%	10.38%
UNDIVIDED INTEREST ASSIGNED	90.00% ASSIGNED TO FEDERAL LAND BANK			
PRINCIPAL OWED BY DEBTOR	$10,000		13.75%	13.75%
VALUE ASSIGNED TO FLB	$90,000		7.00%	10.00%
ANNUAL CASH RENT	7.00% CREDITED TO ACCRUED INTEREST DUE THE FEDERAL LAND BANK.			

PROCEEDS TO FEDERAL LAND BANK INCLUDING BUYOUT COST TO DEBTOR

YEAR	CURRENT INTEREST PAID	CURRENT RENT PAID	TOTAL CURRENT PAYMENTS	BUYOUT COST TO DEBTOR FOR FLB UNDIVIDED INTEREST AND RETAINED INTEREST	TOTAL PROCEEDS TO FEDERAL LAND BANK
1	$1,375	$6,300	$7,675	$102,700	$110,375
2	$1,375	$6,300	$7,675	$105,400	$113,075
3	$1,375	$6,300	$7,675	$108,100	$115,775
4	$1,375	$6,300	$7,675	$110,800	$118,475
5	$1,375	$6,300	$7,675	$113,500	$121,175
6	$1,375	$6,300	$7,675	$116,200	$123,875
7	$1,375	$6,300	$7,675	$118,900	$126,575
8	$1,375	$6,300	$7,675	$121,600	$129,275
9	$1,375	$6,300	$7,675	$124,300	$131,975
10	$1,375	$6,300	$7,675	$127,000	$134,675

THE FARM CREDIT COUNCIL
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Statement

By H. Brent Beesley

Before the

Subcommittee on Agricultural Credit

Committee on Agriculture, Nutrition & Forestry

United States Senate

March 26, 1987

Mr. Chairman and Members of the Subcommittee:

My name is Brent Beesley. I am the President and Chief Executive Officer of the Farm Credit Corporation of America. I am also a member of The Farm Credit Council's Legislative Committee. We appreciate this opportunity to share our views with the Subcommittee.

The Farm Credit Corporation of America was organized in July 1985 by the 37 Farm Credit banks to establish standards, guidelines and policies on Systemwide issues and to be the System's national spokesman. At this time, the three banks in the Texas District are not members of Farm Credit Corporation of America. All 37 banks and nearly all associations of the Farm Credit System are members of The Farm Credit Council.

This week has already been very important for the System. During the last three days, the presidents and farmer-elected directors of the 37 Farm Credit Banks met in Denver to discuss the various alternatives for legislation. The discussions were sobering and the exchanges were frank. These locally-elected directors have a fiduciary responsibility to serve the best interests of all their fellow stockholders. There is a keen awareness of just how critical the coming weeks and months are to the System's future.

At meetings this week in Denver, I am pleased to report that a strong consensus emerged on all of the critical legislative issues facing the Farm Credit System. As a long-time director said to the group, "In all my years of service, I have never seen the Farm Credit System more united in purpose and more resolved to address the problems that now confront us."

Mr. Chairman, I would like to report that the participants in the Denver meeting fully support for the principles and proposals in this statement. The group of farmer directors from all across the Nation overwhelmingly passed a resolution expressing its appreciation to the Congress for the passage of the Farm Credit Amendments Act of 1985 and the Farm Credit Act Amendments of 1986, and they urged that these laws be fully implemented.

Mr. Chairman, you will recall that the System came to Congress two years ago seeking aid. In return, Congress established a process for providing financial assistance when the need was identified and certified.

In 1986, the Congress provided for the use of regulatory accounting practices to lessen the impact of our high-cost debt and excessive loan losses. In both 1985 and 1986 legislation, Congress acted to give the System the tools needed to help us solve our problems without direct Federal financial assistance. We appreciate this demonstration of support and have made a good faith effort to use those tools to the extent allowed by the regulator. During the last two years, the System has:

o shared voluntarily over $1 billion in capital from healthy institutions to weaker ones;

o endeavored to use the Capital Corporation despite regulatory roadblocks;

o adopted a business plan which provides consistent, nationwide policies for pricing, loan restructuring, sales of acquired property etc.; and

o utilized regulatory accounting to redeem borrower stock at par.

All of these actions have helped the System to address its problems and have ensured that the System had access to funds at reasonable costs.

Ultimately, the actions of the 100th Congress will determine the Farm Credit System's ability to serve agriculture in the future. We welcome the debate and the scrutiny of the Farm Credit System. This hearing is being held to explore legislative alternatives that would address the severe financial and debt-related problems throughout much of rural America. You will hear many differing views today and in coming weeks about the appropriate ways to solve these problems. Most importantly, however, we look forward to working with you to find appropriate long-term solutions.

I. BACKGROUND

While we often speak of "American agriculture" as if it were a single industry or "rural America" as if it were a specific place, it is important that we remember that agriculture in this nation is extremely diversified. As you and every member of the Subcommittee know so well, this diversity certainly applies to farmers' views on national farm policies and on the Farm Credit System as well.

As Congress and the Farm Credit System together seek solutions to seemingly intractable problems, the interests of all borrowers -- financially stressed and financially healthy -- must be taken into account. This is the way that a cooperative functions. As Chairman Leahy said recently, "Any long-term solution to Farm Credit's problems must be balanced and fair." While many farmers and ranchers are today currently earning a fair return on their investment, many others are in extreme financial difficulty. As we attempt to resolve the desperate financial problems of some borrowers, we must avoid creating or increasing the problems for others.

Mr. Chairman, there is one generalization that is widely accepted today: farmers and ranchers who are burdened with a high level of debt relative to their incomes and/or asset values are in serious financial difficulty. It is estimated that there are approximately 100,000 farmers and ranchers in this category. In many cases, those in distress simply started farming at the "wrong" time. (Attachment A and B provides information regarding borrowers in financial distress, including information on a geographical basis.)

It is tragically easy to note that those areas which have suffered the greatest declines in land values are the same areas where the debt-related problems are the greatest. (Attachment C indicates the declines in agricultural land values by state or region.)

While we are forced to use numbers and statistics to understand the scope of this problem, we must not forget that behind these numbers are real people, in many cases three and four generations of the same family. These numbers represent a great deal of human suffering and heartbreak.

Mr. Chairman, when borrowers have problems servicing their debts, their respective lenders are inexorably confronted with financial problems of their own. As lenders are unable to collect the loans they have made to farmers, there is considerable pressure to reduce or eliminate lending to farmers in the future. We are seeing growing evidence that many lenders are electing to take their funds out of the agricultural sector.

Virtually every institutional lender to American agriculture obtains the money it lends from someone else. Over the last seventy years, the Farm Credit System has borrowed hundreds of billions of dollars from the investment community and brought this money to American agriculture with great efficiency. This process has resulted in increased competition by other lenders and ensured a dependable source of funds to farmers during both good times and bad.

Consider what would happen if Farm Credit could not repay the $62 billion currently owed to those who have purchased our securities. If the System ever fails to pay its debts as agreed, it is reasonable to assume that the System (and all other government-sponsored entities) would have a difficult, if not impossible task, to obtain funds on Wall Street at a reasonable price. This would, in turn, severely impact our ability to lend money to the farmers who own the Farm Credit System.

The Farm Credit System must continue to be a sound conduit through which an uninterrupted supply of credit flows to farmers, ranchers and cooperatives -- not only to those who are currently financially distressed but to all other agricultural borrowers as well.

Mr. Chairman, as you know the Farm Credit System is in the process of generating the most comprehensive and internally consistent financial forecasts in its history. One of the purposes of this undertaking is to provide the Congress and the Administration with the necessary information to make an informed decision about the need for Federal financial assistance and, if such assistance is needed, to make a correct decision about the timing and amount of such assistance. This project will be completed in late April.

While we will have a very high degree of confidence in the accuracy of these forecasts as of the date they are made, it is very important that we understand that the System's financial condition will be greatly impacted by many factors which are impossible to predict with accuracy. Some of these factors are future interest rate levels, the level of payments through Federal farm programs, land values, and commodity prices. Therefore, we consider that every effort should be made to fashion legislation which provides the flexibility to respond to conditions as they actually develop without the need for Congress to act again on this issue.

II. BASIC PRINCIPLES

Less than two months ago, The Farm Credit Council held its annual meeting at which resolutions guiding the policies of the Council were agreed upon for 1987. These resolutions were the product of District Council meetings over the past six months throughout the twelve Farm Credit Districts. Local farmer-director meetings were held, and these issues were debated. These resolutions are included as Attachment D. They are important to this discussion for two reasons: 1) they are the product of local farmer/borrower input and; 2) they are System-wide consensus positions.

There are two resolutions especially important to this hearing. The first is Resolution 1 entitled, "Support of the Cooperative Farm Credit System: Capital and Structural Needs" which states:

"The Farm Credit Council will support efforts to maintain the necessary procedures and alternatives for capitalizing and funding the Farm Credit System so that reliable and adequate funds are available to its borrowers at the lowest reasonable and competitive price."

The second is Resolution 16 entitled, "Federal Financial Assistance." The Council's policy states:

"If, however, it is determined that such assistance is required, the Council will support Federal financial assistance to the System consistent with the following principles:

1. Assistance should be for the minimum amount necessary and of the shortest duration possible to enable the System to continue to perform its Congressionally mandated mission.

2. Levels of assistance must be sufficient to strengthen borrower confidence and protect borrower stock, and assure full and timely payment of principal and interest to holders of System securities by stabilizing the financial condition and supporting the earning capacity of stressed institutions until U.S. agriculture recovers from its current economic crisis.

3. Financial assistance to the System should not be at the expense of government programs that assist farmer income.

4. Farmer and cooperative-borrower control of the System should be maintained."

These two resolutions provide the foundation upon which the Farm Credit Council's Legislative Committee adopted the following more specific goals for legislation:

A. Financially distressed farmers and ranchers who have the opportunity to recover should be given assistance in weathering the current situation. This assistance should be provided by lenders so long as it does not jeopardize the interests of other borrowers. To the extent that the ability of the lender to provide credit to others is jeopardized, additional assistance to distressed borrowers should be provided by the Federal and/or state governments.

B. Federal financial assistance should be provided to System entities only in the minimum amount required, and such assistance should be repaid as earnings return over time. This was done at an earlier time in the System's history.

C. Legislation should provide considerable flexibility in the timing and amounts of any Federal financial assistance provided.

D. Legislation should preserve the long-term viability of a farmer-owned and controlled, dependable source of credit.

E. Legislation should aid the System in resolving the existing litigation between the System and the Farm Credit Administration.

In addition, while we consider that borrower interest rates should be set a competitive levels, we recognize that the current competitive interest rate levels are high. Further, the rates currently charged borrowers who have no alternative sources of credit are also high. To the extent that interest rates are set below competitive or market levels, the government should provide this interest-rate relief. This interest-rate relief should be available to qualifying borrowers regardless of the lender involved.

Also the System is generally supportive of legislation that would provide funds to all lenders to offer below-market interest rates to financially distressed borrowers and to restructure loans which would otherwise not qualify for restructuring. Currently, loans are restructured only when that is the least cost solution to the lender. Greater flexibility and scope of the Farmers Home Administration's interest rate buy-down and loan guarantee programs may be an appropriate mechanism for this type of borrower assistance.

III. SPECIFIC PROPOSALS

Mr. Chairman, the System is far more united than our critics dare admit. We intend to work together as a System, and we look forward to working with the Subcommittee to refine the following proposals as our financial projections are completed. We also intend to work with our friends in the various groups that represent farmers, ranchers and cooperatives to refine these proposals to meet the needs of their members.

A. Concurrent Resolution on Borrower Stock

Because it is important that there be sufficient time to understand and discuss each of the issues that may be part of a complete agricultural credit legislative package, we urge the Congress to go on record through a resolution stating its commitment to protect the stock, participation certificates and the allocated equities of the farmers, ranchers and cooperatives who own the Farm Credit System. Today a significant number of these owner/borrowers are making the decision to prepay their loans in order to redeem their stock. This loss of loan volume in excess of $1 billion a month is highly detrimental to the long-term recovery and viability of the Farm Credit System.

B. Financial Assistance to the Farm Credit System

Because the System's financial projections will not be completed until late-April, it is currently impossible to outline how much and what kind of financial assistance will be needed by the Farm Credit System, if any. It is also important to recognize that any Congressionally mandated actions will impact the level of assistance needed. We pledge to help this committee quantify those costs as proposals are considered.

We believe that the Farm Credit Act Amendments of 1985 established the appropriate mechanism for providing the System with Federal financial assistance if it is necessary. This law provides for the Farm Credit Administration to certify the System's financial needs to the Treasury and for Treasury to request an appropriation. Appropriated funds would then flow through the Farm Credit System Capital Corporation directly to those Farm Credit System banks and associations in distress.

Levels of assistance should be sufficient to strengthen borrower confidence and protect borrower stock, participation certificates and allocated equities. We further believe that the borrower stock lost in PCA liquidations in the Spokane and Omaha Districts should also be addressed and appropriate measures taken to reimburse these borrowers for their losses.

In order to avoid the need for continued appropriations, the Farm Credit System Capital Corporation should have a line of credit from the Treasury. The specific dollar amount of that line of credit will be recommended by the System when our financial forecasts are completed in April.

C. Farm Credit System Capital Corporation

In addition to its current statutory roles, the Farm Credit System Capital Corporation should be used to resolve the existing loss sharing inequities and the litigation regarding assessments. The Capital Corporation should also be used to assume high-cost debt of the various banks and associations if appropriate. To achieve these objectives, it may be necessary to provide the Capital Corporation with an appropriate line of credit from the Treasury. It is intended that the System would make appropriate contributions to the Capital Corporation as would be established by law to repay any assistance provided pursuant to the line of credit. Contributions to the Capital Corporation, however, must be specifically established and limited-r by Congressional action.

D. Borrower Control of System Structure

Farm Credit has a long and desirable history of borrower control. Existing statutory language which prohibits borrowers from making informed decisions regarding their institutions should be eliminated. We consider that in matters of System structure should be resolved by the owners and directors of the System on a case-by-case basis as business conditions warrant. The current statutory barriers to voluntary mergers of unlike entities should be removed. Mergers of System entities should occur only after full disclosure, debate and stockholder approval.

E. Federal Farm Credit Mortgage Corporation

A secondary mortgage market for agricultural loans could have several benefits for farmers and lenders alike, but it is not a panacea. Of greatest benefit to the farmer would be the increased availability of long-term, fixed-rate loans at more competitive rates. The interest-rate risk associated with these credits would be passed through to the investors through the secondary mortgage market. Of greatest benefit to the lenders would be the increased marketability of their loan portfolios and their increased ability to manage interest-rate risk.

The creation of a secondary mortgage market facility outside the Farm Credit System would most likely have a negative impact on the Federal Land Bank Associations. Therefore, the Farm Credit System has been working with representatives from the other major agricultural lenders, including trade associations of the banking and insurance industries, to consider the development of a secondary mortgage market facility within the Farm Credit System. We have also been visiting with officials from the Farm Credit Administration and the Department of Agriculture.

It is our desire and intent to continue to work with Congressional staff, the American Bankers Association, the Independent Bankers Association of America, and the American Council of Life Insurers and our friends in the various ag and commodity organizations to provide Congress with specific language to create the Federal Farm Credit Mortgage Corporation. Our goal is that this proposal will have the support of all the interested parties.

F. Conservation Reserve

Highly erodible property held by all lenders should be eligible for participation in the Conservation Reserve without limitation. However, lender participation should NOT be in competition with local farmers for a limited allocation of funds.

G. Clarify FCA Responsibilities

FCA responsibilities as an arms-length regulator should be clarified. We anticipate developing language acceptable to both FCA and the System which will address certain aspects of the existing law inconsistent with the current "arms-length regulator" role for the Farm Credit Administration. We have solicited FCA's assistance in preparing this language, and do not expect these items to be controversial.

IV. Conclusion

Mr. Chairman, we look forward to working closely with you, the other Members of Congress in both the Senate and the House of Representatives, the Administration, the Farm Credit Administration, our friends in the various agricultural and commodity groups and even our competitors to find the best solutions possible to these complex issues. We recognize that many of the solutions will have significant costs. The allocation of these costs between the government and the existing and future borrower/stockholders of the Farm Credit System will require careful analysis. Again, we appreciate the privilege of participating in this important hearing.

Attachment A
Page 1

Sole Proprietors Experiencing Financial Stress in Early 1986 By the Year They Began Farming

Year Began Farming	Percent
Before 1960	9
1960-1964	15
1965-1969	21
1970-1974	25
1975-1979	26
1980 and later	35

Source: USDA

Definition of financial stress: Sole proprietors are categorized as experiencing financial stress when they are making partial or no payment on current principal and interest obligations, or their debt-to-asset ratio exceeds 70 percent.

R050/MY2
3/23/87

Attachment A
Page 2

Commercial-Size Farm Operators Experiencing Financial Stress in Early 1986 By Sales Class

Annual Sales ($1,000)	Number of Farms	Percent
$40 to $99	48,000	47
$100 to $249	40,000	39
$250 to $499	10,000	10
$500 to $999	3,000	3
$1,000 or more	1,000	1
Total	102,000	100

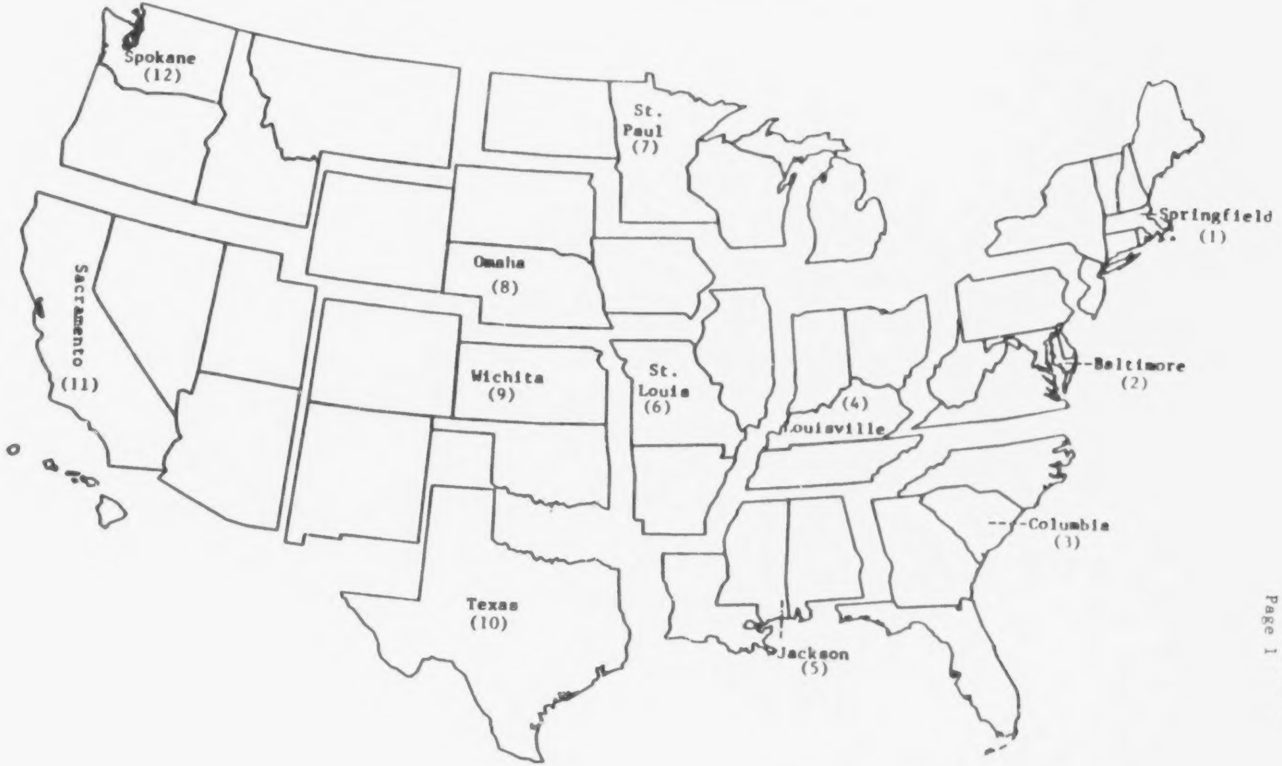
Source: USDA

Definition of financial stress: Farm operators are categorized as experiencing financial stress when they are making partial or no payments on current principal and interest obligations, or their debt-to-asset ratio exceeds 70 percent.

R050/MY1
3/23/87

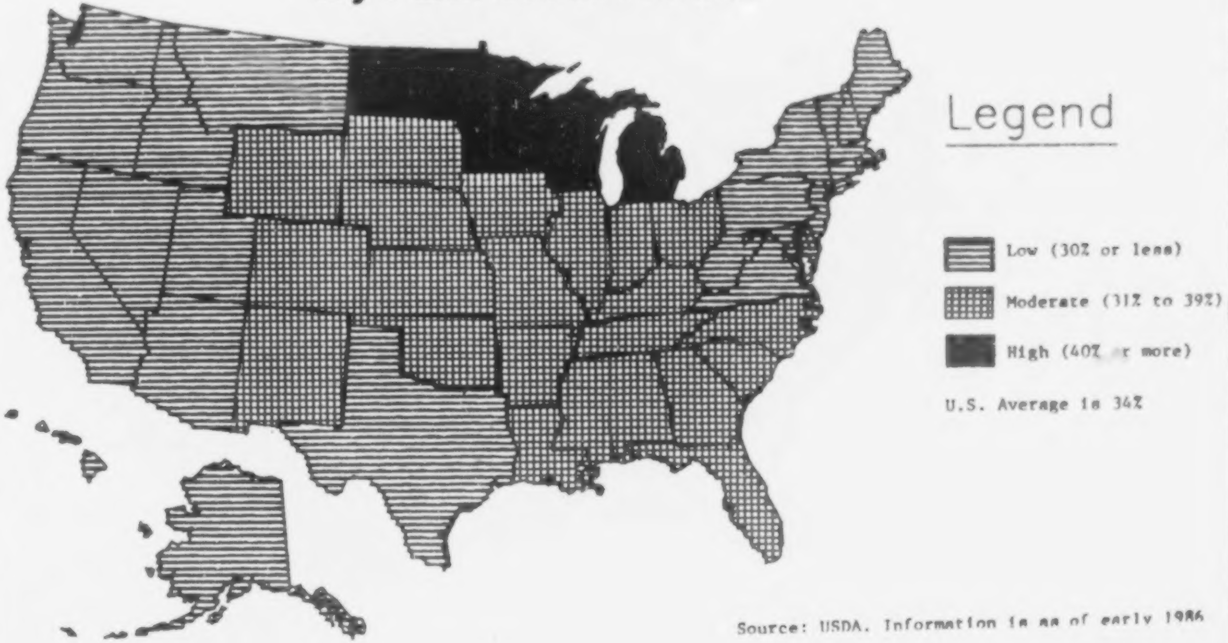
Attachment B
Page 1

TERRITORIAL BOUNDARIES OF THE 12 FARM CREDIT DISTRICTS


Spokane
(12)
St.
Paul
(7)
Springfield
(1)
Omaha
(8)
Sacramento
(11)
Wichita
(9)
St.
Louis
(6)
(4)
Louisville
Baltimore
(2)
Columbia
(3)
Texas
(10)
Jackson
(5)

Attachment B
Page 2

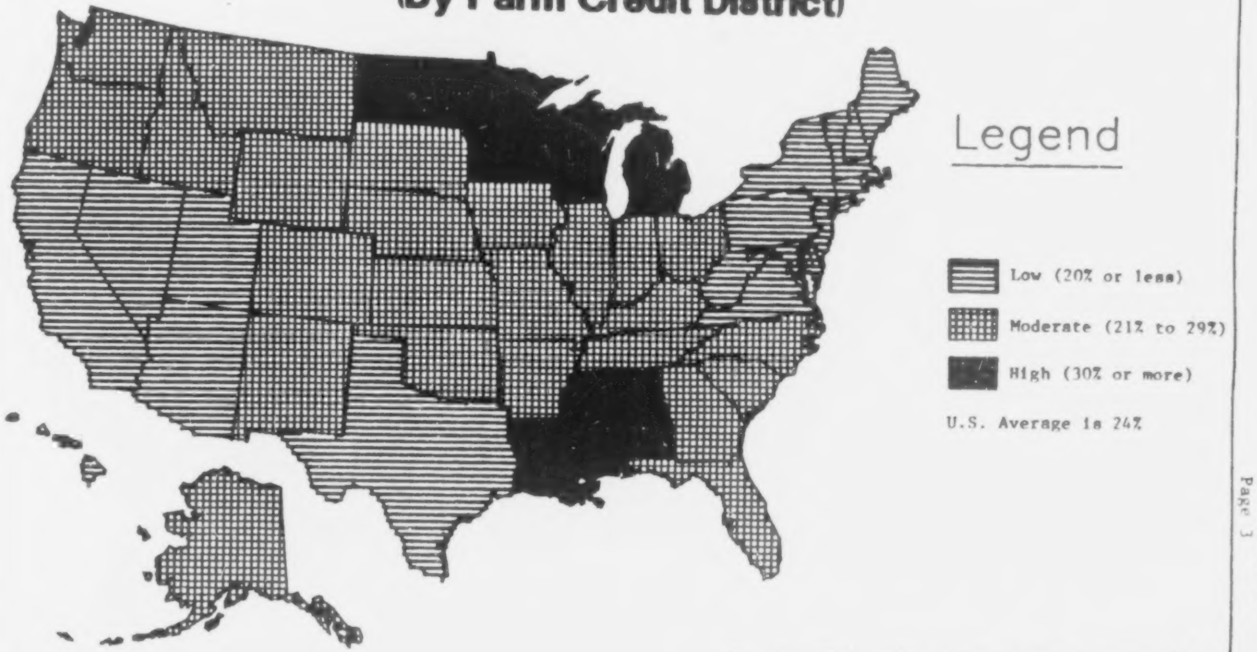
The Percentage of Farmers Who Are:
1) Severely Stressed, or
2) Suffering Significant Losses
(By Farm Credit District)


Legend
▤ Low (30% or less)
▦ Moderate (31% to 39%)
■ High (40% or more)
U.S. Average is 34%

Source: USDA. Information is as of early 1986

Attachment B
Page 3

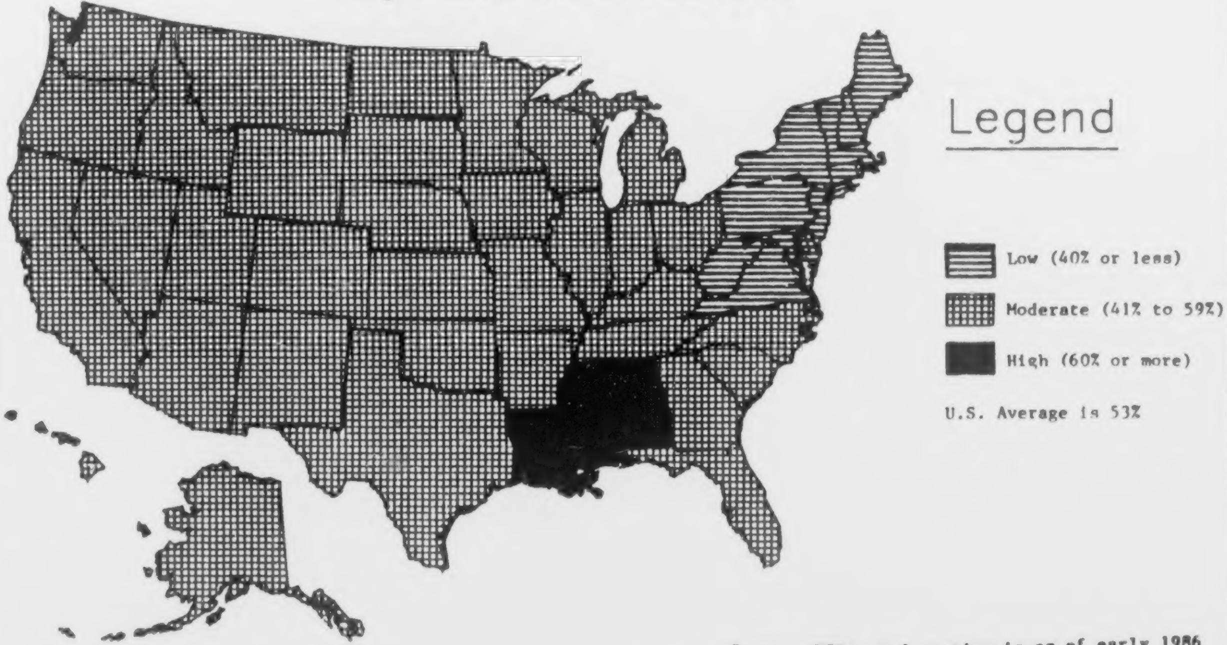
The Percentage of Assets Owned By Farmers Who Are:
1) Severely Stressed, or
2) Suffering Significant Losses
(By Farm Credit District)


Legend
▤ Low (20% or less)
▦ Moderate (21% to 29%)
■ High (30% or more)
U.S. Average is 24%

Source: USDA. Information is as of early 1986

Attachment B
Page 4

The Percentage of Debt Owed By Farmers Who Are:
1) Severely Stressed, or
2) Suffering Significant Losses
(By Farm Credit District)

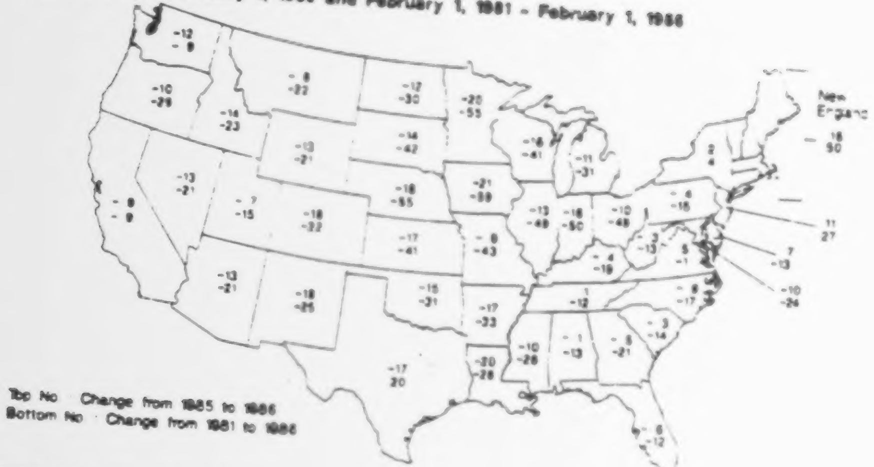

Legend
▤ Low (40% or less)
▦ Moderate (41% to 59%)
■ High (60% or more)
U.S. Average is 53%

Source: USDA. Information is as of early 1986

Attachment C

Percent Change in Average Value of Farm Real Estate Per Acre

April 1, 1985 - February 1, 1986 and February 1, 1981 - February 1, 1986


-12
- 9
-10
-29
- 8
-22
-17
-30
-20
-55
-14
-23
-13
-21
-14
-42
-16
-41
-11
-31
New England
- 18
50
2
4
-13
-21
- 7
-15
-18
-22
-18
-55
-21
-59
-13
-48
-16
-50
-10
-48
- 6
-15
- 9
- 9
-17
-41
- 8
-43
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-13
5
-1
- 4
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11
27
7
-13
-13
-21
-18
-25
-15
-31
-17
-33
1
-12
- 8
-17
-10
-24
- 3
-14
-10
-28
- 1
-13
- 5
-21
-17
20
-20
-28
- 6
-12

Top No. Change from 1985 to 1986
Bottom No. Change from 1981 to 1986

Based on index of average value per acre 1977=100.

Source: USDA Agricultural Resources Publication, June 1986.

Attachment

PERCENTAGE BREAKDOWN OF PURCHASERS OF FARM CREDIT SECURITIES

Category	6/86	6/84	6/82
	percent		
Commercial Banks			
Portfolio	27%	30%	27%
Trust	10	12	11
Investment Advisory and Trading	3	5	5
Total Commercial Banks	40	47	43
State and Local Governments	21	16	13
Mutual, Money Market and Investment Funds	18	12	12
Foreign Purchasers	3	4	8
Thrift Institutions	8	7	6
Pension Funds	2	2	5
Insurance Companies	2	2	3
Nonfinancial Corporations	5	6	4
Individuals	1	3	3
Fraternal, Charitable and Educational	1	1	2
Other Dealers	-	1	1
TOTAL	100%	100%	100%

Source: Quarterly distribution reports submitted by selected selling group members which detail primary sales of Farm Credit securities. For the purpose of this analysis, discount notes, and selected three, six and nine month and term issue bonds were used.

R050/MZ1
3/20/87

1987 RESOLUTIONS OF THE FARM CREDIT COUNCIL

ADOPTED AT THE 4TH ANNUAL MEETING

JANUARY 27, 1987

ISSUE	TITLE
1	Support of the Cooperative Farm Credit System: Capital and Structural Needs
2	Access to Financial Markets: Agency Status
3	Tax Status of Farm Credit System Institutions
4	Sound and Constructive Credit for Agriculture
5	Mandatory Involvement of Cooperative Farm Lenders in the Administration of Government Programs
6	Establishing the Farm Credit Administration as an Effective, Arms-Length, Independent Regulator of Banks and Associations of the Farm Credit System
7	International Financing
8	Farm Products Liens
9	Bankruptcy Reform
10	Rural Utility Lending by Banks for Cooperatives
11	Credit Alternatives and Long Term Profitability in Agriculture
12	Support for Federal and State Agricultural Credit Programs
13	Soil & Water Conservation
14	Borrower Tax-Exempt Financing
15	Support of Farmer Cooperative Collective Activity (Capper-Volstead Act)
16	Government Financial Assistance for the Farm Credit System
17	Interest Rates and Farm Credit Administration Approval Authority

18	Secondary Market for Farm Mortgage Loans
19	Voluntary Merger of PCAs, FLBAs and Banks
20	Tax Treatment of Bad Debt Reserves
21	Reducing Borrower Tax Burden in Loan Workouts
22	Voluntary Debt Mediation
23	Supplier Liens

ISSUE 1: SUPPORT OF THE COOPERATIVE FARM CREDIT SYSTEM: CAPITAL AND STRUCTURAL NEEDS

Support of the Cooperative Farm Credit System: Capital and Structural Needs--The Farm Credit Council believes that the Farm Credit System is of immeasurable value to farmers and ranchers and their cooperatives as well as the nation as a whole, and will support efforts to improve the effectiveness of System institutions through legislative or regulatory reforms. The Council will vigorously oppose efforts to weaken this effectiveness.

The Farm Credit Council will support efforts to maintain the necessary procedures and alternatives for capitalizing and funding the Farm Credit System so that reliable and adequate funds are available to its borrowers at the lowest reasonable and competitive price.

Accordingly, The Council:

- Supports the continued funding of the Farm Credit System institutions through issuance of consolidated Systemwide securities;
- Supports measures, both legislative and regulatory, that will enhance the quality and completeness of disclosure to the investing public and will oppose measures that could impair the integrity of Farm Credit System financial disclosure, including legislation the effect of which would be to prefer equity holders over creditors of System institutions in application of its assets;
- Supports measures that would enhance the System's ability to generate permanent risk capital;
- Urges that the Congress should exercise extreme caution in considering measures that might frustrate needed coordination and accountability as to credit practices and financial stability among institutions which are jointly and severally liable on consolidated Systemwide securities; and
- Supports legislation that would enable such structural adjustments in the Farm Credit System as are necessary to permit greater capital utility and operating efficiencies within and among institutions of the Farm Credit System, including permissive merger of System institutions with informed stockholder approval.
- Encourages leaders among the Farm Credit Banks to continue to swiftly and decisively address capital needs of System institutions as they arise, and the Council will support measures, legislative or otherwise, to maintain System capital at levels deemed vital to the financial stability of the System as a whole and its component entities in times of stress, provided, however, that the effect of such measures is not to politicize the Farm Credit System and its process for the extension of credit on a sound and constructive basis. (1st Adopted 1/9/84, Reaffirmed 1/22/85, Revised 1/21/86, Revised 1/27/87)

ISSUE 2: ACCESS TO FINANCIAL MARKETS: AGENCY STATUS

Access to Financial Markets: Agency Status--In providing for the Farm Credit System, it was Congress' objective to provide for a "permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit." The Farm Credit Council believes that the maintenance of the System's agency status is essential to not only that objective but to the health of American agriculture as well. Therefore, The Farm Credit Council strongly supports the maintenance of the Farm Credit System's present funding authorities to assure the continued access to ample funds for financing of farmers, ranchers and their cooperatives. The Farm Credit Council will strongly oppose efforts to restrict the System's access to financial markets through federal credit budgets, modification of its agency status or any other means--including the imposition of a penalty fee for the use of agency status. (1st Adopted 1/9/84, Revised 1/22/85, Reaffirmed 1/21/86)

ISSUE 3: TAX STATUS OF FARM CREDIT SYSTEM INSTITUTIONS

Tax Status of Farm Credit System Institutions--The institutions of the Farm Credit System serve a vital and growing role in providing capital for American agriculture. This role is in pursuance of a congressionally-mandated mission of providing sound and constructive credit to all sectors of agriculture and has not diminished in the years since these institutions were first chartered. They continue to operate with limited charters and thus with loan assets necessarily concentrated in a single industry. Therefore, to better assure their ability to meet the future credit demands and to maintain reasonable loss reserves, The Farm Credit Council will strongly support retention of the current tax status of the Farm Credit System institutions. (1st Adopted 1/9/84, Reaffirmed 1/22/85, Reaffirmed 1/21/86)

ISSUE 4: SOUND AND CONSTRUCTIVE CREDIT FOR AGRICULTURE

Sound and Constructive Credit for Agriculture--The Farm Credit Council supports policies that will assure the availability of adequate credit at the lowest reasonable cost to all segments of agriculture, including full- and part-time farmers. We also fully endorse and subscribe to a policy of forbearance. Farm Credit institutions are committed to remaining with their distressed borrowers and to restructuring troubled loans on a case-by-case basis as the preferred alternative to foreclosure when:

- the borrower has been cooperative with the bank or association and has acted in good faith to manage his business affairs;
- there is a reasonable prospect for the borrower's financial recovery demonstrated through a realistic financial plan; and
- the loss borne by the other borrower/stockholders of the bank or association can be minimized through the loan restructuring alternative chosen.

Foreclosure should be avoided unless and until there is no reasonable alternative course of action remaining. We recognize, however, that the position of Farm Credit System securities in the national money markets is predicated upon an underlying commitment to extension of adequate credit on a sound and constructive basis. The Farm Credit Council will, therefore, oppose blanket foreclosure moratorium proposals and any other action, either legislative or administrative, which would require banks and associations of the Farm Credit System or other cooperative farm lenders to extend or administer credit on any basis other than by application of sound credit factors. (1st Adopted 1/9/84, Revised 1/22/85, Revised 1/21/86, Revised 1/27/87)

ISSUE 5: MANDATORY INVOLVEMENT OF COOPERATIVE FARM LENDERS IN THE ADMINISTRATION OF GOVERNMENT PROGRAMS

Mandatory Involvement of Cooperative Farm Lenders in the Administration of Government Programs--The Farm Credit Council supports the maintenance of active working relationships with agencies of the government in their extension and administration of credit and farm program benefits. The Farm Credit Council will oppose any action, legislative or administrative, which would mandate participation of cooperative farm lending institutions or their employees in the administration of any government program. Farm Credit System institutions and other cooperative farm lenders are not government agencies, are not funded by the government agencies, are not funded by the government, and are neither staffed nor equipped to perform governmental functions. Any such involuntary participation is inconsistent with the private sector nature of these institutions and would impair their ability to carry out their private sector function of serving the credit needs of American agriculture. To the extent such participation is not also required of other private sector lending institutions, it is inequitable and anticompetitive as well. (1st Adopted 1/9/84, Reaffirmed 1/22/85, Reaffirmed 1/21/86)

ISSUE 6: ESTABLISHING THE FARM CREDIT ADMINISTRATION AS AN EFFECTIVE, ARMS-LENGTH, INDEPENDENT REGULATOR OF BANKS AND ASSOCIATIONS OF THE FARM CREDIT SYSTEM

Establishing the Farm Credit Administration as an Effective, Arms-Length, Independent Regulator of Banks and Associations of the Farm Credit System--The Farm Credit Administration (FCA) is an independent federal agency established by Congress to provide for the regulation and examination of the institutions of the Farm Credit System under P.L. 92-181, as amended. The Farm Credit Council favors continued independent status for FCA and will oppose initiatives which would serve to diminish its independence in agency operations or to politicize its operations.

The Farm Credit Council stresses the importance of establishing FCA as an effective, arms-length regulatory agency. The Council believes that the Farm Credit Administration Board should include, among its members, individuals whose qualifications include extensive experience in or knowledge of co-operatively organized agricultural credit institutions.

The Farm Credit Amendments Act of 1985 was designed to establish FCA as an arms-length regulator of System institutions. Accordingly, we believe that the involvement of FCA in the management of the banks should be eliminated, and we urge swift implementation of FCA authorities to grant approvals through regulations that confer approval of actions of Farm Credit institutions that meet standards and criteria established by FCA. In addition, we believe the Farm Credit Act Amendments of 1986 should be implemented in a manner that minimizes the involvement of FCA in System business decisions.

The Council also notes that, as an arms-length regulator, the agency will be required by Congress to report on the conditions of System institutions. The Council encourages the Farm Credit Administration to clarify that it is not a spokesman for the System to Congress or the general public. At the same time, the Council will encourage the Congress to exercise continued oversight of the activities and budget of FCA to assure an appropriate level and cost of System regulation that is consistent with that of other Federally regulated financial institutions.

The Farm Credit Council will carefully monitor regulations promulgated by the Farm Credit Administration. When appropriate, the Council will express its views on whether or not the proposed regulations conform with the intent of Congress to ensure the competitive viability of System institutions under arms-length regulation by FCA to protect their safety and soundness. (1st Adopted 1/9/84, Reaffirmed 1/22/85, Revised 1/21/86, Revised 1/27/87)

ISSUE ~~7:~~ INTERNATIONAL FINANCING

International Financing--The Farm Credit Council encourages and will support legislative or administrative changes necessary for the institutions of the Farm Credit System to achieve full and continued implementation of international financing programs with the goal of broadening the effectiveness of cooperatives in such areas as foreign trade and marketing beyond U.S. borders. (1st Adopted 1/9/84, Revised 1/22/85, Reaffirmed 1/21/86)

ISSUE 8: FARM PRODUCTS LIENS

Farm Products Liens--The Farm Credit Council believes that the availability of farm production loans at reasonable cost is crucial to a healthy agricultural and national economy. Typically, the biological production of farm products is financed with loans for which those same products serve as both primary security and the principal source of repayment. The importance of farm products security as a key factor in the loan decision is recognized in the farm products exception to Section 9-307(1) of the Uniform Commercial Code, which would otherwise permit sale of farm products free and clear of liens.

The Farm Credit Council strongly opposes legislation the sole effect of which would be the elimination of the farm products exception. The Council recognizes that, as enacted in most states, Section 9-307(1) and the notice provisions of the Code do not, as a practical matter, assure potential buyers notice of outstanding liens sufficient to enable them to protect their interest in purchased farm commodities. It is the position of the Council that the problem is one of notice which arises under state law, and the Council will support solutions consistent with the following principles:

- It is in the interest of all segments of the industry to ensure that the farm products lien is satisfied;
- All segments of the industry, including producers, buyers and lenders, should therefore share responsibility for ensuring that the lien is satisfied; and
- Those who divert collateral proceeds or otherwise abuse the process should suffer stiff criminal penalties. (1st Adopted 1/9/84, Revised 1/22/85, Reaffirmed 1/21/86)

ISSUE 9: BANKRUPTCY REFORM

Bankruptcy Reform--The Farm Credit Council recognizes that the nation's bankruptcy laws exist to afford relief for improvident debtors in order that they might be permitted to start again. We believe, however, that those laws must provide for the orderly and timely handling of the bankrupt estate while providing a reasonable and equitable measure of protection for the creditors according to their undertakings. Of necessity, every bankruptcy imposes a cost upon all borrowers. When, however, the process permits excessive delays or when the process is otherwise abused, the cost is unwarranted and excessive. Therefore, The Farm Credit Council favors legislative changes that would safeguard the integrity of the process while better protecting against abuses by those who employ the bankruptcy laws as a shield solely to hinder or delay their creditors. (1st Adopted 1/9/84, Reaffirmed 1/22/86, Reaffirmed 1/21/86)

ISSUE 10: RURAL UTILITY LENDING BY BANKS FOR COOPERATIVES

Rural Utility Lending by Banks for Cooperatives--The Farm Credit Council supports and will facilitate development of amendments to the Farm Credit Act of 1971 or other legislative or administrative actions which would enable the Banks for Cooperatives to more effectively serve the financial needs of rural utility systems. (1st Adopted 1/9/84, Reaffirmed 1/22/85, Reaffirmed 1/21/86, Revised 1/27/87)

ISSUE 11: CREDIT ALTERNATIVES AND LONG TERM PROFITABILITY IN AGRICULTURE

Credit Alternatives and Long Term Profitability in Agriculture--As the result of low commodity prices, natural disasters, high interest rates, and sharply declining asset values, American agriculture is experiencing severe economic stress. These conditions are hastening and intensifying a major transition in agriculture--its structure, production capacity, and markets.

During this stressful time, many farm borrowers are encountering severe debt repayment problems. Consequently, many farm lenders are also experiencing extreme financial stress. We believe that current conditions are so severe that extraordinary efforts will be required by all parties--borrowers, lenders and government--to achieve an appropriate solution. Any effort to address the immediate problems must recognize that:

- Agriculture's transition must be evolutionary and not revolutionary. Both borrower and lender alike need sufficient time to successfully adjust.
- The institutions serving agriculture must find short-term alternatives to normal operations that will facilitate transition in an orderly manner that is both compassionate toward borrowers while preserving of those institutions on which agriculture must depend in the future.
- Private sector farm lenders are borrowers too. Their ability to attract the necessary loan funds to serve agriculture is dependent upon their own financial strength. In order to maintain that strength, lenders must operate on sound business and credit principles.
- Many of the current problems in agriculture have been prompted by international and macro-economic policies of government in recent years. Therefore, government should participate substantially in the short-term programs necessary to facilitate that transition.
- The use of government and private resources is best determined at the local level and on a case-by-case basis.

Specifically, to address the immediate borrower and lender problems, The Farm Credit Council will support legislative and/or regulatory alternatives which will stabilize farm asset values, and permit the government to assume a greater share of the risk of farm financing while providing the support necessary for lenders and those borrowers who have a reasonable chance of recovery to adjust during this time of transition.

Agricultural credit alternatives for the short term, however, will be futile without the prospect of long-term profitability for U.S. agriculture. Credit is no substitute for income. As the representative of those farmer-owned organizations which hold a third of the nation's farm debt, it is incumbent upon The Farm Credit Council and its member organizations to aggressively communicate to the Congress and the American public the message that "profitability must be restored to the farming sector; it is vital to the economic and social health of America." (1st Adopted 1/22/85, Reaffirmed 1/21/86)

ISSUE 12: SUPPORT FOR FEDERAL AND STATE AGRICULTURAL CREDIT PROGRAMS

Support for Federal and State Agricultural Credit Programs--The Farm Credit Council believes that the Farmers Home Administration (FmHA) has a vital role to play as a "lender of last resort" to American farm borrowers. The Council believes that FmHA must have sufficient loan funding and personnel to meet the legitimate needs of those agricultural producers who are unable to qualify for credit from private commercial or cooperative sources, but who have a reasonable prospect for success in farming. Further, the Council believes it is imperative that FmHA provide appropriate advice and counsel to the farmers it finances regarding their prospect for success in farming.

The Council and its member Farm Credit institutions are dedicated to cooperation and coordination with FmHA in such areas as the FmHA guaranteed loan and approved lender programs. The Council will encourage FmHA to revise these programs as necessary to make them more beneficial to borrowers and acceptable to all lenders. We recognize that the mutual efforts of America's private cooperative and commercial lenders and FmHA are needed to minimize the effects of the current adversity in agriculture.

In order to address more fully this current adversity in agriculture and to expedite the availability of credit before other interim measures can be put in place, The Farm Credit Council will support the following with respect to existing FmHA programs:

- Implementation of a combined interest subsidy/guaranteed loan program;
- Expansion of the current guaranteed loan authority; and
- Targeting of FmHA programs to those areas where borrowers' debt problems are most severe.

In addition, the Council believes several new programs being implemented by state governments will serve to bolster the efforts of FmHA to serve the credit needs of those most affected by the current financial stress. The Council supports these programs but notes that System institutions can only participate in them when their terms and conditions are consistent with the System's debt restructuring policy. The Council will work through the District Councils with states to assure that these programs constructively and cost effectively meet the needs of borrowers and not serve, in the long run, to limit the availability of private credit to agriculture. (1st Adopted 1/22/85, Revised 1/21/86, Revised 1/27/87)

ISSUE 13: SOIL AND WATER CONSERVATION

Soil and Water Conservation--As the largest provider of credit to agriculture, the member institutions of The Farm Credit Council have a substantial stake in encouraging good soil conservation practices. The Council recognizes and strongly supports the need to maintain the productivity of soil resources. The Council will seek changes in current law to allow highly erodible farm properties acquired by financial institutions to be placed in the conservation reserve. In addition to preserving soil and water resources, this change will reduce government price support costs and the oversupply of farm products. The Council will also oppose efforts that would require private lending institutions to impose loan approval restrictions on farmers and ranchers to meet soil and water conservation objectives. (1st Adopted 1/22/86, Revised 1/21/86, Revised 1/27/87)

ISSUE 14: BORROWER TAX-EXEMPT FINANCING

Borrower Tax-Exempt Financing--Section 4.16 of the Farm Credit Act has been construed to prohibit any extension of credit or commitment by a Farm Credit institution which has the principal effect of facilitating the marketing of debt obligations or instruments the income of which is exempt in whole or in part from federal taxation. Yet, The Farm Credit Council believes it is incongruous that in attempting to obtain lowest-cost financing through tax-exempt financing, borrowers would be unable to obtain assistance from their own cooperative farm lenders which are borrower-owned institutions dedicated to improving the income and economic well-being of American farmers and ranchers. The Farm Credit Council will therefore support legislative or administrative changes needed to enable institutions of the Farm Credit System to provide credit and related services to eligible borrowers in support of their tax-exempt financings. (1st Adopted 1/22/85, Reaffirmed 1/21/86)

ISSUE 15: SUPPORT OF FARMER COOPERATIVE COLLECTIVE ACTIVITY (CAPPER-VOLSTEAD ACT)

Support of Farmer Cooperative Collective Activity (Capper-Volstead Act)-- The rights of farmers, ranchers and fishermen to act together in collectively processing, preparing for market, handling and marketing their products is essential to the continuation of a strong agricultural economy. Accordingly, The Farm Credit Council believes that the Capper-Volstead Act is fundamental to the existence of marketing cooperatives and to the ability of Banks for Cooperatives to provide credit and related services to them. Therefore, the Council will vigorously oppose initiatives which would weaken protections afforded farmers and their cooperatives by the Capper-Volstead Act. (1st Adopted 1/22/85, Reaffirmed 1/21/86)

ISSUE 16: GOVERNMENT FINANCIAL ASSISTANCE FOR THE FARM CREDIT SYSTEM

Government Financial Assistance for the Farm Credit System--As single industry lenders to U.S. agriculture, the banks and associations of the Farm Credit System are severely impacted by the current financial stress among the nation's farmers and ranchers. The ability of these institutions to continue as dependable providers of credit has been put in serious jeopardy by the continuing deterioration in the farm economy and by the resulting erosion of farmer and investor confidence in the Farm Credit System. A financial crisis in the System would in turn adversely impact thousands of farmers, their cooperatives, as well as the entire national economy.

The Farm Credit Amendments Act of 1985 specifically authorizes government financial assistance for the Farm Credit System. The Council notes that the Act requires the System to first contribute its own resources to help itself, but establishes specific criteria which would assure that such contributions do not prevent System institutions from making credit available on reasonable and competitive terms and which would assure that such contributions do not include borrower investment. Further, the Act makes financial assistance contingent upon certification by the Farm Credit Administration as to the System's need for it in providing credit on reasonable terms.

The Farm Credit Council believes that the criteria established in the Farm Credit Amendments Act fairly protect the taxpayer while safeguarding the competitive viability of System institutions. The preference of the System continues to be to pursue reasonable alternatives designed to lessen if not eliminate altogether the need for government financial assistance. If, however, it is determined that such assistance is required, the Council will support Federal financial assistance to the System consistent with the following principles:

1. Assistance should be for the minimum amount necessary and of the shortest duration possible to enable the System to continue to perform its congressionally-mandated mission.
2. Levels of assistance must be sufficient to strengthen borrower confidence and protect borrower stock, and assure full and timely payment of principal and interest to holders of System securities by stabilizing the financial condition and supporting the earning capacity of stressed institutions until U.S. agriculture recovers from its current economic crisis.
3. Financial assistance to the System should not be at the expense of government programs that assist farmer income.
4. Farmer- and cooperative-borrower control of the System should be maintained.
5. Government involvement in the System should be minimal.
6. Extension and administration of credit should not be politicized.

7. Except for ongoing regulatory supervision, the government's involvement with the System should end with the expiration of any assistance package.

8. While a strong and independent Federal regulator with powers similar to those held by other financial institutions regulators is necessary to protect the safety and soundness of System institutions, the involvement of the Farm Credit Administration in the management of System business affairs either directly or through the Capital Corporation should be eliminated. (1st Adopted 1/21/86, Revised 1/27/87)

ISSUE 17: INTEREST RATES AND FARM CREDIT ADMINISTRATION APPROVAL AUTHORITY

Interest Rates and Farm Credit Administration Approval Authority--To be viable providers of credit to U.S. farmers, ranchers and cooperatives, Farm Credit System institutions must have the flexibility to price loans and services at competitive levels and in a manner that timely responds to changing market forces. The Farm Credit Act Amendments of 1986 specifically terminated the authority of the Farm Credit Administration to approve interest rates set by System institutions. Further, the legislative history of the 1986 Amendments made clear that any effort by the Farm Credit Administration to use other authorities to require System institutions to charge interest rates that are noncompetitive would be inconsistent with the intent of Congress. The Council will work to ensure that the Farm Credit Act Amendments of 1986 are fully implemented and their intent followed. (1st Adopted 1/27/87)

ISSUE 18: SECONDARY MARKET FOR FARM MORTGAGE LOANS

Secondary Market for Farm Mortgage Loans--The Farm Credit System was established to serve as a permanent system to assure an adequate and flexible flow of loan funds into rural America and to assure that the credit needs of farmers and their cooperatives are met. To meet that need, agriculture, through the Farm Credit System, was provided special access to the Nation's financial markets--access that is as much dependent on the financial health of U.S. agriculture as an industry as it is on the financial health of the System. The Farm Credit Council believes that U.S. agriculture benefits greatly from this national access to capital. The Council believes as well that agriculture benefits from having diverse sources of long-term farm real estate financing at the local level, but questions the need for an additional Federally-sponsored entity to provide increased liquidity to the farm mortgage market. The Council further believes that, under present or expanded authorities, the Farm Credit System can provide sufficient liquidity to the farm mortgage market to ensure an adequate supply of competitively priced credit for agriculture. The Council will support any legislative changes identified as necessary to allow the Farm Credit System to provide a secondary mortgage market mechanism. (1st Adopted 1/27/87)

ISSUE 19: VOLUNTARY MERGER OF PCAs, FLBAs AND BANKS

Voluntary Merger of PCAs, FLBAs and Banks--In order to more effectively and efficiently provide financial services to their members, many Farm Credit district boards have elected to establish common management of their banks and associations. Provisions of current law which preclude the merger of "unlike" banks or associations limit the economies and efficiencies which can be derived from further streamlining of System institutions. Therefore, The Farm Credit Council believes the Farm Credit Act should be amended to permit the voluntary merger of PCAs, FLBAs and banks on the basis of informed stockholder approval. (1st Adopted 1/27/87)

ISSUE 20: TAX TREATMENT OF BAD DEBT RESERVES

Tax Treatment of Bad Debt Reserves--The Tax Reform Act of 1986 repealed the bad debt reserve deduction of the Banks for Cooperatives and the Production Credit Associations. This change will unnecessarily increase the financial burden on Farm Credit System institutions during the current period of economic stress. The Farm Credit Council believes that increasing the tax burden on System banks and associations is inconsistent with the policy that the System dedicate its resources to solving its current financial problems in order to avoid or minimize the need for direct Federal financial assistance. Therefore, the Council will work with Congress and the Administration in seeking to reinstate the bad debt reserve deduction for System institutions. (1st Adopted 1/27/87)

ISSUE 21: REDUCING BORROWER TAX BURDEN IN LOAN WORKOUTS

Reducing Borrower Tax Burden in Loan Workouts--In the present adverse agricultural environment, financially stressed borrowers and their lenders must seek solutions to troubled loans that will result in the least direct cost to all parties concerned. In certain cases, the least cost workout option in terms of both time and money for the lender would impose a significant tax penalty for the borrower. The result is a loan workout package designed to meet the vagaries of the tax code, rather than the most efficient settlement of a business transaction. It remains the policy of the System that in pursuing a loan workout the institution should seek the least costly alternative to foreclosure. However, this policy is too often frustrated by the current tax code, resulting in additional costs that must be borne by the remaining System borrowers.

The Farm Credit Council will, therefore, support legislative or regulatory changes which would eliminate inconsistent and adverse tax consequences associated with the least costly workout of troubled loans, but in so doing shall seek a solution which will minimize the tax consequences for troubled borrowers. (1st Adopted 1/27/87)

ISSUE 22: VOLUNTARY DEBT MEDIATION

Voluntary Debt Mediation--The Farm Credit Council believes that voluntary mediation can prove helpful in facilitating dialogue between financially stressed farm borrowers and their lenders. The Council notes that successful farm debt mediation programs supported by public funds and private donations have been established in various states. Experience indicates that voluntary mediation can help to facilitate the reasonable, rational and responsible resolution of differences between farm creditors and borrowers facing financial difficulties.

At the same time, The Farm Credit Council strongly objects to the imposition of mediation programs which delay legal proceedings and result in substantial costs for all parties concerned. For cooperative farm lenders these costs are borne by all farmer members of the credit institution. (1st Adopted 1/27/87)

ISSUE 23: SUPPLIER LIENS

Supplier Liens--The Farm Credit Council takes note of the respective interests of lenders and farm input suppliers regarding "the supplier lien" issue. We encourage lenders and suppliers to work together to resolve this issue in a way that is as fair and simple as possible and does the following:

A. Enables both the supplier and lender to calculate, in advance, their risk positions.

B. Discourages unsound credit practices by lenders and suppliers.

C. Provides for notification to the lender of any supplier lien, so that the lender can monitor his loan, insure payment to the supplier and therefore extinguish the supplier lien if so desired. (1st Adopted 1/27/87)

STATEMENT OF DR. NEIL E. HARL, PROFESSOR OF ECONOMICS, IOWA STATE UNIVERSITY, AMES, IA, ON BEHALF OF THE NATIONAL PORK PRODUCERS COUNCIL

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to submit this information for your study and record.

The Farm Credit System faces two serious problems—(1) achieving stability in the near term as loan losses have absorbed available reserves and, (2) restructuring to help meet the credit needs of agriculture long-term. Although the first problem is now commanding the attention of policymakers and others, the second is highly important for the long-term health of agriculture.

Left, alone, the System appears to be incapable of dealing with the twin problems it faces and would be expected to press for preservation of the System largely in its present form. The recommendations on "Restructuring The Farm Credit System" which are contained in the report we are presenting today on behalf of the National Pork Producers Council, focuses attention upon the credit needs of the sector and the plight of heavily indebted farm borrowers. The recommendations in this report reflect the realities of a severely weakened and downsized Farm Credit System, heavy concentration of debt among farm borrowers and budgetary constraints on governmental assistance.

The report recognizes that a secondary market, with adequate credit enhancement to enable the market to withstand periods of adversity in agriculture, could make a significant contribution to agricultural lending. It is anticipated that such a secondary market would be created as a unit of the Farm Credit System to take advantage of agency status and would be accompanied by adequate regulatory authority and appropriate levels of farmer involvement in control to assure fair and reasonable terms of access to the market.

With respect to restructuring the Farm Credit System, the report favors creation of an FDIC-type fund to assure repayment of System-issued bonds and notes and decentralization of the System to the district bank levels as each bank is viewed as a separate center for purposes of control and for purposes of profit and loss. Such decentralization should bring to the System a degree of externally imposed market discipline which has heretofore been lacking. Access to funds from System-issued bonds and notes would be assured to commercial banks on an unimpeded basis to maintain competition in agricultural lending and to assure credit availability in areas where units of the System are unable to survive and rebuild a capital base.

To assist district banks in stabilizing loan portfolios, assistance is envisioned through—(1) an adequately funded program enabling purchases of troubled loans by the Capital Corporation, (2) a direct infusion of capital to weakened district banks by the federal government or, (3) a targeted program of interest buydowns. The latter offers several distinct advantages over the other two possibilities.

The report I present to you today on behalf of the National Pork Producers Council, recognizes that significant amounts of funding will be required for any rescue operation and cautions that diversion of funds from price and income support would place an additional segment of borrowers at risk.

Thank you for your time. We will be pleased to answer any questions you may have.

RESTRUCTURING THE FARM CREDIT SYSTEM

A REPORT PREPARED BY DR. NEIL E. HARL

The rapidly deteriorating condition of the Farm Credit System assures that assistance will be needed in 1987 if the system is to avoid financial instability. The amount, type and timing of assistance are all critical in terms of influence on the long-term configuration of the system and on the extent to which the problems of heavily stressed farm borrowers are addressed.

Various patterns are possible and feasible for providing assistance to the Farm Credit System. This paper, which encompasses recommendations of the National Pork Producers Council, discusses one set of alternatives as outlined in Figure 1.

SECONDARY MARKET

The concept of a secondary market for mortgage-backed farm real estate loans would provide a number of important advantages in connecting primary mortgage lenders with final investors. Eventually a secondary market could embrace properly backed non-real estate loans as well. It is anticipated that originating lenders would retain at least a 10 percent interest in the loan and would continue to service the loan account. It is envisioned that the secondary market would be operated within the Farm Credit System, to take advantage of the System's agency status, perhaps as a subsidiary of that organization. The market would be accessible by units of the Farm Credit System, commercial banks, insurance companies and other regulated farm lenders.

The greatest concern about the secondary market is in handling loan losses. While the strong collateral requirements for loans (with loans limited to 50 to 60 percent of collateral value) and the 10 percent retained ownership of the loan by the originating lender would provide substantial assurance that investors would not suffer losses, it is almost certain that losses in periods of cyclic downturns in agriculture (similar to the 1930's and 1980's) would exceed those margins. For that reason, a reserve fund should be maintained as a credit enhancer. Initially, the reserve fund could be secured by an explicit government guarantee which would be phased out as capital reserves are accumulated based upon a modest percentage of the value of loans sold into the secondary market.

To assure responsiveness of secondary market operations to the needs of agriculture for a dependable source of credit at reasonable cost, it would be important to have appropriate farmer involvement in the control of the secondary market operation.

It is important to note that a secondary market could fit with any configuration of a restructured Farm Credit System.

DECENTRALIZATION OF THE FARM CREDIT SYSTEM

In considering the various possibilities and options for restructuring the System, it is recognized that two features of the System are vital to a delivery system of farm credit expected to remain in place over the next several decades—(1) a long-term land-lending capability and, (2) an efficient mechanism for obtaining funds in the central money markets. Conceivably, the Farm Credit System could transition toward—(1) a central land bank, serving the entire country, (2) a central bank for cooperatives and, (3) a wholesaling function for other credit needs with funds for production credit and land loans channeled through other established lenders.

Such a severe restructuring is not envisioned at this stage. Rather, restructuring is suggested that would—(1) provide an opportunity and strong encouragement for district banks to regain their position as an effective supplier of credit and to rebuild capital bases and, (2) to create a different mechanism for assuring the repayment of System-issued bonds and notes.

The latter point is fundamental to long-term health and stability of the System. The experience of the 1980's as the Farm Credit System was over-whelmed with a deteriorating loan portfolio has been that stronger districts respond in support of districts weakened by loan losses only grudgingly and after the issuance of edicts by the Farm Credit Administration. Stronger districts have mounted legal challenges to the pooling of capital system-wide. It seems unwise to continue such a procedure for responding to adversity.

One feasible approach would be to decentralize the system with greater autonomy at the level of district banks. Each district bank would be viewed as a profit and loss and control center and would be free to expand business operations outside present district boundaries. Each district bank would be expected to rebuild and maintain an adequate capital base for bank operations. Weaker districts would perhaps need some protection from competition from other districts as capital accounts are rebuilt. It is envisioned that district banks would continue the long tradition of an appropriate level of farmer involvement in management and control but with strong emphasis on a high level of professional input in control and in executive management.

To implement a decentralized approach, some modification would be required with respect to joint and several liability for consolidated system-wide bonds and notes. In addition, on-going assurances would be needed to assure that investors in bonds and notes would be paid interest and principal on schedule. To handle both functions, it is envisioned that an FDIC-type fund would be created to provide such assurance. The fund would respond after district bank capital had been reduced to specified minimum levels. Initially, the fund would be backed by government guarantees which would be phased out as reserve amounts (based upon a percentage of loans made by district banks) reached an adequate level.

The amount and timing of government assistance will determine whether borrower-owned stock in the System will be protected. Assurances were given in 1985 that borrower-owned stock would not be at risk. However, it is clear that districts with impaired stock cannot continue to redeem stock at par value without accelerating capital loss.

ASSISTANCE WITH TROUBLED LOANS

The proposal for a restructured Farm Credit System, perhaps with a more refined and responsive degree of decentralization to the level of district banks, and with greater autonomy and accompanying responsibility, addresses long-term problems of bank and system stability but does not address near term problems facing district banks. In several of the districts, financial assistance will likely be needed if the banks are to survive.

In order for weaker district banks to have a reasonable opportunity to rebuild capital, and to assure farm borrowers an opportunity to become financially and economically stable, assistance in some form will be needed—(1) to district banks in restructuring farm loans or, (2) to borrowers in servicing loan obligations. Indications are that the cost would be approximately the same in either case.

Three alternatives for providing the assistance seem feasible—(1) provide sufficient funding to the Capital Corporation such that troubled loans could be purchased from district banks and from other farm lenders, (2) provide an infusion of limited accounts of capital from the U.S. Treasury directly to district banks as needed or, (3) implement a targeted interest buy-down program with several times more funding than provided in the Food Security Act of 1985. The objective of the latter type of program would be to reduce the interest rate for borrowers with good management skills to approximately the rate of return on farm assets.

A program of interest rate buy downs on a targeted basis would have the advantage of directing assistance toward making borrowers financially stable, which is a root cause of System instability, rather than addressing a mere symptom of the problem, lender instability. Moreover, a program of interest rate buy downs would have the advantage of treating all borrowers equitably regardless of nature or identity of lender. While weakness of the Farm Credit System is understandably the central concern, borrowers from other lenders face identical problems.

A program of capital infusion to weakened district banks or an adequately funded effort to purchase troubled loans from weakened district banks would be of assistance to the Farm Credit System and might provide modest interest rate relief to System borowers. Such programs would not, of course, address the problems faced by other borrowers.

Any intervention effort, whether available to lenders or to borrowers, must at some point provide for determinations of which farm operations are to be liquidated, which farm operations are to be restructured and which farm operations are to be ineligible for intervention benefits. In all instances, an "upside" eligibility test is necessary to identify operations that are capable of being or becoming economically stable without intervention assistance and a "downside" eligibility test to identify operations incapable of becoming economically stable even with intervention assistance.

For all programs of assistance, it is vital for the parties to recognize the importance of loan restructuring rather than loan liquidation. Loan restructuring is appropriate whenever management skills are not in question and the borrower demonstrates an ability to become stable at a lesser cost than would be incurred with loan liquidation through foreclosure or other creditor action. By restructuring is meant rescheduling of principal payments, reduction of interest rates and possible forgiveness of some principal.

EXPANDED OFI WINDOW

To assure adequate credit in all areas on a dependable basis at reasonable cost, it seems highly advisable to provide for unimpeded access to the "Other Financial Institutions" (OFI) window of the Farm Credit System. It is acknowledged that OFI window access has been available to commercial banks and other eligible institutions but such access has been rarely utilized. Under a restructured System, it is envisioned that commercial banks would be assured access to loanable funds as needed through the issuance of Farm Credit System bonds and notes. Competition among lenders in rural areas should be enhanced as a result.

In areas where district banks were unable to rebuild capital and maintain a viable presence in agricultural lending, the Farm Credit System would become essentially a wholesaler of credit with both production credit and land loans made by commercial banks in accordance with regulations governing lenders acquiring funds through the Farm Credit System.

FUNDING NEEDED

Funding needs for federal intervention are of two types—(1) funds to make the Farm Credit System stable as a lender and, (2) funds to make borrowers substantially stable. Funds devoted to stabilizing borrowers would also contribute to making lenders stable, also, as borrowers would be better able to meet principal and interest payment obligations. The amount of funding needed to stabilize the Farm Credit System has been estimated as high as $8 to $10 billion. The total cost will vary by type of intervention, the degree and nature of restructuring prescribed and the extent to which assistance is extended to borrowers from other lenders.

A program of interest rate buydowns coupled with the necessary funding to assure repayment of System bonds and notes as a reserve fund is accumulated would place the cost of intervention on an annual basis in the range of $3.5 billion by present estimates. Additional intervention in the form of guarantees could be needed to assure continued confidence of bond holders.

There is an acute awareness of budgetary pressures at the federal level and the relatively large amount of funding, by historical standards, going into farm price and income support programs.

To the extent that credit assistance is funded from amounts diverted from price and income support programs, an additional segment of borrowers is placed at risk as farm incomes decline. While the credit problems in agriculture cannot be solved through price and income supports alone, the amount of income buoyancy is critical to resolution of the farm debt problem. Any reduction of farm income increases the need for targeted programs of assistance for borowers.

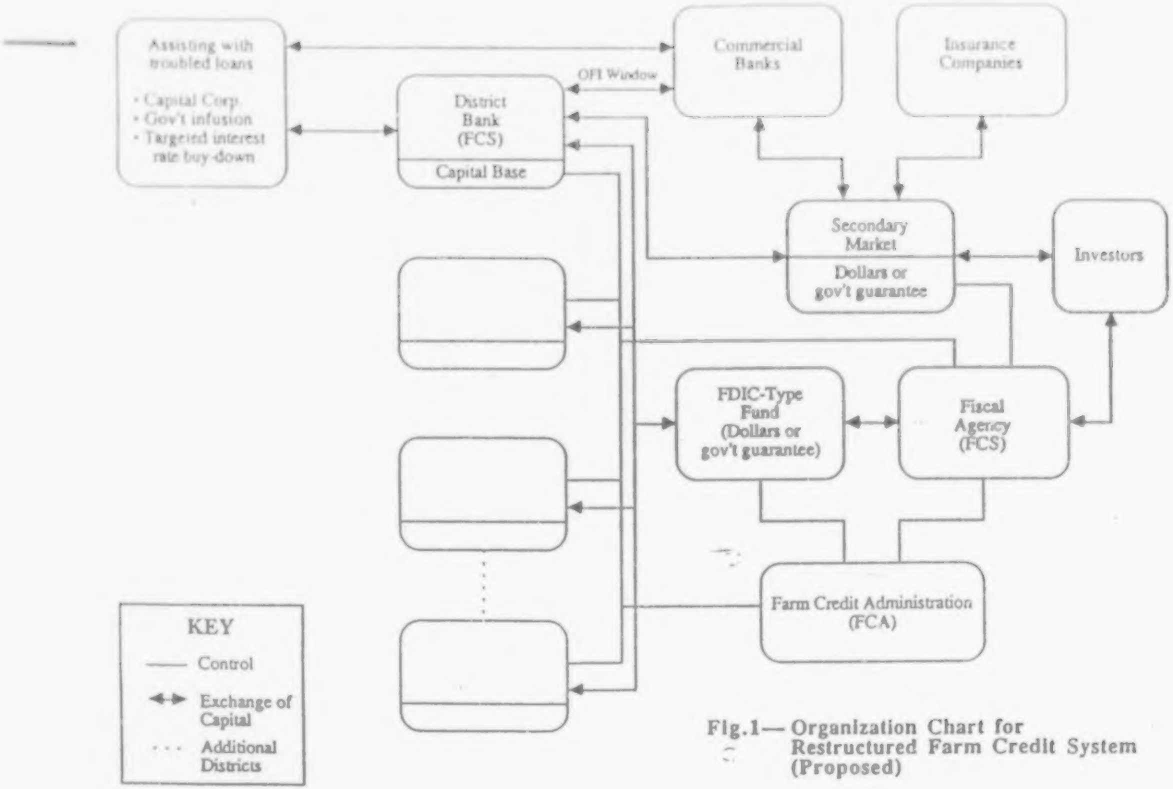
Assisting with troubled loans
• Capital Corp.
• Gov't infusion
• Targeted interest rate buy-down
District Bank (FCS)
Capital Base
OFI Window
Commercial Banks
Insurance Companies
Secondary Market
Dollars or gov't guarantee
Investors
FDIC-Type Fund (Dollars or gov't guarantee)
Fiscal Agency (FCS)
Farm Credit Administration (FCA)
KEY
Control
Exchange of Capital
Additional Districts

Fig.1— Organization Chart for Restructured Farm Credit System (Proposed)

STATEMENT OF JACK DAHL, PRESIDENT, NATIONAL CATTLEMEN'S ASSOCIATION

The National Cattlemen's Association is the national spokesman for all segments of the beef cattle industry—including cattle breeders, producers and feeders. The NCA represents approximately 230,000 cattlemen. Membership includes individual members as well as 49 affiliated state cattle associations and 23 national breed associations.

Thank you Mr. Chairman. My name is Jack Dahl. I am a cattleman from North Dakota and currently serving as President of the National Cattlemen's Association. We appreciate the opportunity to join others in sharing ideas and expressing concerns about agricultural credit before this committee. In particular, we are delighted at your eagerness and leadership to move forward swiftly.

In 1985, and again in 1986, NCA worked with this committee and the rest of Congress, as well as other agricultural groups, to get the best deal for borrowers, the people we represent. Last December, NCA established an Agricultural Credit Task Force to seek solutions to the agricultural credit problem that impedes all of agriculture. Particularly under the leadership of Jimmy Powell, a rancher from Texas, our association has been actively involved in the credit issue for years. While these efforts have been helpful, they are at best temporary. A more encompassing solution is needed for a more permanent fix.

Certainly, planning and looking ahead are common terms used today to help agriculture. Most farm organizations support leaving the farm bill alone. We strongly concur.

Cattlemen are businessmen, thus, we want certainty in order to plan and make long-term decisions that best benefit our operations. The credit situation in agriculture is troublesome and uncertain. The quick-fix, make-it-to-the-end-of-the-field type approaches have done nothing to change this uncertainty. Broad-based credit legislation is necessary to rectify the uncertainty and help all of agriculture to service its debt.

Our task force is in the process of developing the elements that we feel must be included in a piece of broad-based credit legislation. Obviously, the Farm Credit System is the cornerstone. The FCS needs to be restructured. Streamlining this credit system is necessary for it to be competitive and provide money for our producers at reasonable interest rates. With decentralization, centralization, or whatever you want to call this process, the bottomline must be to ensure the system becomes more efficient and cuts the fat. Our task force is considering proposals that allow individual FCS entities to "go independent," issuing a new class of stock and selling to outside investors.

Borrower confidence in the Farm Credit System is essential if it is to continue as a viable entity. Existing borrowers must know that their money and their stock is safe, and new borrowers must be confident in the future of the system. The 1985 legislation reestablished investor confidence in farm credit bonds. This continued confidence level is a must in any type of legislation that is passed in 1987.

A guarantee of "B" stock would provide certainty to existing borrowers and new borrowers, but is only the first step. The big problem that continues to especially confront the troubled districts and the areas of our country where relief is needed the most, is the adverse credit situation. The producer or borrower cannot fully service nonperforming loans under the current situation. Legislation, in whatever form, must allow either individual entities, individual districts or a centralized structure to work with borrowers in restructuring these loans where possible in order to get things moving once again.

Another piece of the puzzle includes a secondary market for agricultural mortgages. Competition and a menu of interest rates and loan terms can only mean that borrowers, our members, will be getting the best deal possible. Falling land values have continued to erode the equity base from which our members borrow to finance their operations. A secondary market, which expands credit available to farmers and ranchers, would help shore-up land values and bring new buyers into the market under their terms, not the creditor's terms. Our task force will be addressing this issue further at the beginning of next week. It is the stabilizing factor in a legislative package.

As I stated earlier, these same problems confront other commercial sources of credit. Our task force has looked at options that would allow local PCAs, federal land banks and agricultural lenders to participate in the same type of workout structure. It would be a grave mistake and would do little to remove the uncertainty, if legislation only included the secondary market, the restructuring of FCS and failed to address the issue of adverse credit and nonperforming loans. We need an organized game plan for restructuring and working through these troubled loans.

We support the continued movement of FmHA from a source of direct lending to that of a loan guarantor.

Mr. Chairman, let me restate the points NCA feels should be included in a credit package:

1. Legislation reestablishing existing borrower and new borrower confidence in the Farm Credit System.
2. Continue streamlining of the Farm Credit System.
3. Allow local FCS entities to explore creative methods of raising capital.
4. A secondary market for agricultural mortgages that increase rate and term options available to buyers.
5. Adverse credit and nonperforming loans must be restructured or worked out. Legislation should include the financial backing to effectively accomplish this key element.
6. Any legislation must recognize that the problem is larger than the FCS.

Our task force is meeting in Washington next Monday and Tuesday, March 30 and 31 and our Board of Directors on April 1, 2, and 3. At that time, the members of this task force, with one representative from every region of the country, will further develop recommendations on this very important issue of agricultural credit, adding meat to these bare-bone ideas. This task force is composed of cattlemen with expertise in various areas of the credit arena. They have backgrounds in the Farm Credit System, FmHA, agricultural banks and obviously practical backgrounds in the production of cattle and other agricultural commodities.

Mr. Chairman, in light of the fact that our task force will be meeting next week, we would like the opportunity to supplement our views today by including further ideas and proposals that evolve from these meetings in today's hearing record. We will continue to work with other agricultural groups and interested parties in helping you develop a complete credit package.

Thank you.

TESTIMONY OF LUMAN W. HOLMAN

on behalf of

GRASSROOTS: THE NATIONAL ASSOCIATION OF
FARM CREDIT SYSTEM STOCKHOLDERS

and

THE FEDERAL LAND BANK ASSOCIATIONS
OF TEXAS STOCKHOLDERS' DEFENSE FUND

My name is Luman Holman. I am from Jacksonville, Texas and appear today on behalf of Grassroots: the National Association of Farm Credit System Stockholders ("Grassroots") and on behalf of the Federal Land Bank Associations of Texas Stockholders' Defense Fund ("Defense Fund"). I am Executive Director of Grassroots and Chairman of the Tyler Federal Land Bank Association.

Grassroots was organized by farmer/rancher borrowers of the Farm Credit System and has representation from each of the 12 Farm Credit Districts. It is composed of PCA people, Land Bank people and people interested in cooperatives. The Defense Fund represents farmer/rancher borrowers from 42 of the 44 Land Bank Associations in Texas.

The aim of these shareholder organizations is precisely the aim set out in the policy and objectives section of the Farm Credit Act itself, namely, "to encourage farmer- and rancher-borrowers' participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit. . . ."

In my testimony before this Subcommittee on February 26, 1987, I discussed the ruinous and troublesome problems confronting us -

(1) the continuing failure to give interest rate reduction and foreclosure relief to the farmers themselves,

(2) FCA's continuing failure to do what Congress intended and to administer the 1985 and 1986 amendments in a way that will allow the banks in the system to help farmers,

(3) the continuing private agenda of some of the systems' top management - our employees - to replace the present decentralized thirty-seven bank structure with a single central entity, and

(4) the clear need for legislation to address these problems and restore the focus of system institutions to that of helping the farmer/rancher borrowers.

In that testimony I discussed the meeting that Grassroots held in Des Moines, Iowa last winter, attended by people from each of the twelve Farm Credit Districts, in order to discuss new legislation. In my earlier testimony I outlined nine principles that were agreed to at the Des Moines meeting, as well as four additional borrower rights proposals to ensure that farmer/rancher borrowers are treated fairly.

Today, I have attached to my testimony a proposed Bill, with ten titles, that puts into legislative language the goals outlined earlier. Also attached is a section-by-section analysis of the Bill.

The first three titles are aimed directly at helping farmers and include:

Title 1, providing for interest rate reduction;

Title 2, providing for borrower relief by forbearance and restructuring efforts;

Title 3, providing for specific borrower rights.

Titles 4 through 7 address the functioning of system institutions and their relationship with the regulator and with each other, as well as addressing the need for creation of a Reserve Fund that can be used by the regulator to assist ailing system entities. In these titles, we believe that we will effectively solve the problems that are now tying the system up in litigation across the country, thus ending the basis for the litigation.

Finally, in Titles 8, 9, and 10 we look beyond the present need of borrowers to the future requirements of this system to ensure its operation as a true owner-borrower coopertive with real local control, with a cooling off period for mergers and with adequate reporting back to the systems owners from the Funding Corporation.

Collectively these provisions address, we believe, the issues of greatest concern to the borrowers, to the banking institutions involved, and to the regulator. In a sense, the provisions work together to produce a result greater than if any one of them were singled out. Overall, we believe these provisions address the relevant needs and do so in a way that leaves a permanent infrastructure in place, with the correct incentives for those participating in the System to act responsibly in the future. Our provisions represent an intense effort of self-help by those participating in the System to utilize its own resources first, to make use of government guarantees as far as that technique will be useful, and to involve direct Treasury assistance only for a limited time and only in a form that goes directly to the farmer/borrower in the form of lower interest rates.

Before going into more detail about the things we believe Congress should do in new farm credit legislation, let me first point to several parts of the Farm Credit Act that, in our view, do not need fixing.

We must not abandon the principle that borrowers must hold meaningful amounts of stock in the system and must not accept the idea that token stock requirements are acceptable. Stock indicates ownership.

We do not need to abandon joint and several liability.

We do not need to downsize district banks.

Others have suggested that local control would be furthered by these three steps. We strongly disagree.

Now let me turn to a brief discussion of each title of our Bill.

Title I mandates an across-the-board interest rate reduction of five percentage points on all Farm Credit System loans for two years. Two points are funded by the Treasury. One point is funded by the System. Two points are funded by the application of up to fifty percent of borrower stock, as a credit against interest otherwise due. This is an across-the-board program because the struggling borrower should not have to become delinquent before he becomes eligible for help.

Title II sets up a program for borrower relief through forbearance and restructuring. The House Government Operations Committee, chaired by Congressman Jack Brooks, found in 1986 that "the system tended to use foreclosure on delinquent loans as a first resort, rather than attempting to work out problems before foreclosure." (House Report 99-566, April 29, 1986, "Farm Credit Administration's Role in the System's Crisis".). Under our bill, institutions will be required to consider at least the options presented to determine if some forbearance or restructuring would be in the best interest of the borrower and offer reasonable protection to the institution. Loan write-downs are not mandated, because we believe that they offer an incentive to delinquency instead of encouragement to success. If a borrower cannot make it, however, we offer a lease-back buy-back program. The institution takes title to loan collateral, leases it back to the borrower if he is viable, and allows repurchase within ten years at a price to be agreed upon at that time. Acquired property under this program can be used as bond collateral, which removes the need under current law for banks facing deficiencies in collateral to sell acquired property to generate cash, which continues to force down the price of land.

Title III directs that borrowers cannot be required to provide additional collateral on loans that are current, or be foreclosed on for failing to do so. This title also affirms that borrowers have a right under the Farm Credit Act to sue System institutions and the Farm Credit Administration for abuses.

Title IV mandates the uniform use of regulatory accounting. The extraordinary short-term costs that the System is suffering due to huge loan loss reserves and high-cost debt are gobbling up our earnings. This title requires that these costs be amortized over twenty years.

Title V removes several very great threats to local control in the System. It sunsets the Farm Credit System Capital Corporation, which has been used to promote system centralization and has never done the job of financial assistance that Congress created it to do. It also terminates other service organizations, with their 400 + employees and huge budgets including the "Central Entity" Farm Credit Corporation of America. However, the Federal Farm Credit Banks Funding Corporation is left in place.

Title VI accelerates current law and empowers the Farm Credit Reserve Fund to take the place of the Capital Corporation in providing financial assistance to troubled institutions. The Reserve's initial funding is through a one-time issuance by all banks of an uncollateralized obligation in the amount of $1.5 billion, guaranteed by the Treasury. This provision allows the System to finance the bulk of its own assistance operations without exacerbating the System's present collateral difficulties. The Reserve will be maintained perpetually at a sound operational level by payments into it of up to one percent of the proceeds of each bond issued by one or more banks of the System. The Reserve shall ensure that institutions can continue to provide Farm Credit services in their territories. The Reserve will also be responsible for guaranteeing borrower stock for a five-year period while borrower confidence in the System is being reestablished.

Title VII terminates the present inter-bank loss sharing agreements in the System because they would conflict with the proper operation of the Reserve.

Title VIII provides a new right of election in the stockholders of a system bank to have a separate board of directors for that bank if they so choose. We believe that the stockholders of any bank should have the right to have a board that is fully accountable to them.

Title IX requires a cool-off period following a vote of association merger, during which association stockholders can petition for a meeting to reconsider. This provision is designed to insure that mergers only be executed with stockholders fully and truthfully informed and in agreement. We must not forget that the Government Operations Committee, chaired by Congressman Jack Brooks, formally reported to Congress last year that "FCA supervised the merger election process in a manner which allowed district bank officials to use misstatement of facts and threats of coercion to persuade stockholders to approve districtwide mergers." That Committee recommended that: "The Chairman monitor closely any future merger elections to insure that members of associations will have adequate and accurate information well in advance of the date for the balloting."

Title X requires the Federal Farm Credit Banks Funding Corporation to make annual written reports to system institutions detailing its operations.

Enactment of this bill will help the farmer-borrowers, will help the System's banking institutions, and will give the regulator the tools (and the responsibility) it needs, while responding to the constituent pleas from home that you are hearing as Members of Congress. We urge you to enact the provisions we are suggesting.

This concludes my formal testimony. I would be pleased to answer any questions you may have.

Attachments follow:

FARM CREDIT RELIEF, REFORM
AND
LOCAL CONTROL ACT OF 1987

Section-By-Section Analysis:

TITLE I--INTEREST RATE REDUCTION

Section 101 mandates a reduction in the billing rate on all Farm Credit System loans, starting on the date of enactment of the Act and lasting for two years. The rate shall be reduced on all outstanding and new loans, and shall be in addition to any voluntary rate reduction made by any System institution.

Subsection (a) mandates a two percentage point reduction which shall be funded by direct payments from the Secretary of the Treasury to each Farm Credit System lender equal to the amount by which interest payments on loans held by that lender are reduced by operation of this subsection.

Subsection (b) mandates a one percentage point reduction which shall be funded by each Farm Credit System lender with respect to its loans. This subsection uses institution rates on January 1, 1987 as benchmarks in order to avoid discouraging rate reductions during the consideration of this Act.

Subsection (c) mandates a two percentage point reduction to be funded by applying up to one-half of each borrower's stock, as allocated to each of his or her loans, against interest that the borrower would owe but for the reduction contained in this subsection. This two percentage point reduction shall terminate with respect to a loan sooner than the general rate reduction mandated by this section if the stock credit allocable to that loan is exhausted.

Subsection (d) provides for a five-year guarantee of borrower stock as part of this rate reduction program. The terms of that guarantee are set out in section 601 of this Act.

TITLE II--BORROWER RELIEF: FORBEARANCE AND RESTRUCTURING

Section 201 adds a new Part G to Title IV of the Farm Credit Act of 1971 to establish a meaningful program of borrower relief alternatives.

A new section 4.40 requires that all banks and associations shall have a forbearance program that provides at least the borrower forbearance opportunities specified. First, on the written request of a borrower with respect to a loan that is about to become, or is, delinquent a bank or association shall determine whether the borrower meets three forbearance criteria: (1) whether the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations; (2) whether the borrower has the financial capacity and the management skills to protect collateral from diversions, dissipation or deterioration; and (3) whether the borrower is capable of working out his or her existing financial difficulties, re-establishing a fully viable operation and paying the loan on a rescheduled basis. For borrowers meeting the three criteria, the bank or association shall then consider whether the borrower would be benefitted, and the association protected, by a formal or informal agreement to a late payment or payments, by deferral for some period of the payment of all or part of the principal otherwise due, by the extension of the term of the loan through reamortization or by the institution refraining for some period to exercise a right with respect to the loan otherwise granted by the loan documents or applicable law. Appropriate financial information may be required by the bank or association in view of the forbearance option or options under consideration. A right of appeal is provided.

A new section 4.41 provides that a bank or association shall not foreclose a mortgage if the borrower: (1) is doing his or her honest best and is cooperative; (2) is applying income over and above necessary living and operating expenses to the payment of primary obligations;

(3) is taking proper care of the property; and (4) has the capacity to work his or her way out of a reasonable burden of debt under normal conditions.

A new section 4.42 encourages Farm Credit System institutions to permit borrowers in foreclosure, bankruptcy or voluntary liquidation to retain possession and occupancy of his or her principal residence, and a reasonable amount of adjoining land, to maintain his or her family. This section encourages use of the lease-back buy-back program, as set out in the next section, for homestead protection.

A new section 4.43 establishes a lease-back buy-back program to avoid displacing viable agricultural operators and depressing the value of land in the region. Under this program, a bank or association may take title to loan collateral and may lease all or any part of it back to the borrower if that borrower is a viable operator, or to any other viable operator (giving special consideration to operators of family-size farms and to beginning farmers) if the borrower is not viable or does not want to participate. Collateral to which title has been taken may be held by an institution for not longer than ten years. If the institution leases the property to the borrower, the lease agreement shall contain a repurchase option covering the whole or any part of the collateral, exercisable at any time as agreed between the institution and the borrower, at a price to be determined at the time that the option is exercised. The option price shall not exceed the amount of loan principal outstanding when the institution took title, plus any interest that would have accrued from that date to the date of repurchase. This section also specifically permits the value of loan collateral to which an institution has taken title pursuant to this section to be used as bond collateral. This corrects a defect under current law which does not allow the value of acquired property to be used as bond collateral, thus forcing banks faced with a deficiency in collateral to sell acquired property to generate cash, which results in further depressing land values in the region. A borrower shall have a right of appeal from decision made under this section. The lease-back buy-back program shall not apply to land that the bank or association believes should not be in agriculture, or to highly erodible land or converted wetland.

TITLE III--BORROWER RIGHTS

Section 301 amends Part C of Title IV of the Farm Credit Act of 1971 to be a Borrower Rights subtitle.

A new section 4.21 is added to the Farm Credit Act of 1971 to protect borrowers, with respect to any loan that is current under the terms of the loan agreement, from: (a) being required to provide additional collateral; (b) being foreclosed on or otherwise liquidated for failing to post additional collateral; or (c) being required to furnish additional financial information unless the borrower is requesting a change in the terms of the loan agreement.

Section 4.13A of the Farm Credit Act of 1971 is amended to provide borrowers with a right, at any time, to obtain copies of all documents signed or delivered by the borrower and a copy of the institution's articles of incorporation or charter and by-laws.

Section 302 adds a new section 5.38 to the Farm Credit Act of 1971 to affirm that borrowers have a right to sue, in federal court, any institution of the Farm Credit System for violation of any duty, standard or limitation owing to the borrower and for violation of any order issued by the Farm Credit Administration with respect to any such duty, standard or limitation, and to sue the Farm Credit Administration for failure to perform any Act or duty to the extent that it is not discretionary. Borrowers have standing if they have suffered legal wrong or are aggrieved or adversely affected by the violation or violations on which their suits are based. This section specifically does not restrict any right which any borrower or any other person (or class of borrowers or other persons) otherwise has under the Farm Credit Act of 1971, any other statute or the common law.

TITLE IV--UNIFORM USE OF REGULATORY ACCOUNTING

Section 401 mandates the use of uniform regulatory accounting to amortize over twenty years two types of extraordinary short-term System costs. Capitalization of these costs is specifically made retroactive to January 1, 1986, and shall last through December 31, 1988. These accounting changes shall increase the book value of borrower stock for purposes of stock retirements, which shall be redeemed using these regulatory accounting principles.

Subsection (a) mandates the capitalization and amortization of extraordinary additions to loan loss reserves (in excess of one-half of one percent of loans outstanding).

Subsection (b) mandates the capitalization and amortization of extraordinary interest costs on high price debt (interest costs in excess of 6.0 percent on all individual, joint and System-wide obligations).

TITLE V--SUNSET OF THE CAPITAL CORPORATION AND HALT TO SYSTEM CENTRALIZATION THROUGH SERVICE ORGANIZATIONS

Section 501 sunsets the Farm Credit System Capital Corporation at an earlier date than the 1990 expiration provided for in the 1985 Amendments.

Subsection (a) provides that the authority and existence of the Farm Credit System Capital Corporation shall terminate on the ninetieth day after the effective date of the Act.

Subsection (b) provides that liquidation shall follow as soon as practicable after termination, and that the distribution of assets shall be to those Farm Credit institutions that contributed to the funding of the Capital Corporation under section 4.28G(a)14 of the Farm Credit Act of 1971, in proportion to their contributions. Distributions shall be decreased by amounts already received as financial assistants or otherwise already returned.

Subsection (c) is a conforming amendment to delete Section 4.1 of the Farm Credit Act of 1971.

Section 502 halts System Consolidation and merger through service organizations such as the Farm Credit Corporation of America.

Subsection (a) removes all authority from the Farm Credit Administration to charter any entities except Federal land banks, federal land bank associations, Federal intermediate credit banks, production credit associations, banks for cooperatives, the Central Bank for Cooperatives, and the Federal Farm Credit Banks Funding Corporation.

Subsection (b) provides that all service organizations terminated on the effective date of this Act by the removal of the Farm Credit Administration's chartering authority shall be liquidated within ninety days after the effective date. The Federal Farm Credit Banks Funding Corporation is specifically continued as a body corporate. The Funding Corporation shall have no authority to extend credit, to set policy, to prescribe lending limits or standards, to make any lending decisions, to hold any primary System capital, to assume in any manner the primary responsibility of System institutions to service System borrowers, or to provide insurance services for borrowers from System institutions.

Section 503 is a conforming amendment to specify in Section 1.2 of the Farm Credit Act of 1971 that the Farm Credit System shall consist only of entities chartered under the authority of the Farm Credit Administration, as limited by this title.

TITLE VI--FUTURE STABILITY THROUGH FARM CREDIT RESERVE FUND

Section 601 accelerates the start of operations of the Farm Credit Reserve Fund, which current law provides as a replacement for the Capital Corporation when that Corporation is sunsetted. This section amends Section 4.9A of the Farm Credit Act of 1971 to provide for the start-up of the Reserve within thirty days after the effective date of this Act. The Reserve shall be held solely in Treasury securities, demand deposits and such other investments as are guaranteed as to principal and interest by the United States. The Farm Credit Administration shall use the

Reserve to make financial assistance available to financially troubled institutions of the Farm Credit System so as to insure that Farm Credit services will continue to be available to borrowers in the institution's territory. The Farm Credit Administration shall have an additional obligation to use the Reserve, for a period of five years starting on the effective date of this Act, to make such payments to banks and associations as are necessary to prevent borrower stock from being retired at less than par. The Reserve shall be funded initially through the one-time issuance of an uncollateralized joint obligation of the banks of the Farm Credit System in the amount of $1.5 billion, which shall be guaranteed by the United States. The Reserve shall also have paid into it all proceeds from the liquidation of any service organization pursuant to Section 502 of this Act. The perpetual funding of the Reserve shall be through the contribution of up to one percent of the proceeds from each note, bond, debenture or other obligation issued by one or more banks under the Farm Credit Act of 1971, as ordered by the Farm Credit Administration without the burden falling unfairly on individual banks or bank groups. Contributions shall be temporarily suspended if the Reserve contains the lesser of: (1) an unobligated sum that exceeds the amount necessary to achieve the purposes of the Reserve, as determined by the

Farm Credit Administration giving due regard to the possibility of unexpected System or institution financial difficulties; or (2) an amount equal to three percent of the total of System loans outstanding on December 31 of the preceding year made to persons other than System institutions. Reserve amounts in excess of the maintenance level shall be rebated to banks in proportion to their contributions during the period determined by the Farm Credit Administration as having generated the excess. Financial assistance from the Reserve shall be repaid when the Farm Credit Administration determines that the bank or association can do so and the need for financial assistance is reduced or no longer exists. The Farm Credit Administration shall issue regulations implementing this section.

TITLE VII--TERMINATION OF LOSS SHARING THAT CONFLICTS WITH THE RESERVE FUND

Section 701 deletes the statutory authority for inter-bank agreements to share losses. The 37-Bank Capital Preservation Agreement, the Federal Land Banks Capital Preservation Agreement, the Federal Intermediate Credit Banks Capital Preservation Agreement and the Banks for Cooperatives Loss Sharing Agreement are terminated retroactively to January 1, 1986, and any actions taken under those agreements from January 1, 1986 through the effective date of this Act are reversed.

TITLE VIII--LOCAL CONTROL

Section 801 provides for a new method under which the stockholders of any System bank (or the borrowers from or subscribers to the bank's guarantee fund) shall be able to choose to have a separate Board of Directors for that bank. The procedures are set forth in a new Section 5.3A of the Farm Credit Act of 1971. Consideration of a separate board is initiated by a petition to the Farm Credit Administration by a stockholder or stockholders of any bank (or one or more borrowers from or subscribers to the guarantee fund of a bank for cooperatives) representing at least twenty-five percent of the total number of votes that may be cast by the bank's stockholders (or subscribers) in the election of directors. Within thirty days, the Farm Credit Administration shall issue a notice to all stockholders (or subscribers) explaining that a referendum has been called and stating the time and place of a special stockholders' meeting. The meeting shall be held not less than thirty or more than sixty days from the date on which the notice is mailed. If a majority of the votes represented at such meeting are cast in favor of the election of a separate Board of Directors for the bank, the Farm Credit

Administration shall proceed to hold elections for a separate board. Each separate Board of Directors shall be composed of five members. Two members of the original separate board shall be the District Board members already elected by the bank's stockholders (or subscribers), who shall no longer be members of the District Board. The other three original members, and all succeeding members, shall be elected and serve in accordance with Sections 5.1 and 5.2 of the Farm Credit Act of 1971. If separate boards are established for two or more banks in a District, the District Board for that District shall be terminated. Coordination between Boards of Directors in a District on matters such as joint property, functions or policy shall be by committee composed of representatives from each board in the district. A separate Board of Directors established pursuant to this section shall continue until abolished by the same election procedure. If a majority of the votes represented at the special shareholders' meeting called to consider abolition of the separate Board of Directors are cast in favor of abolition, the separate Board shall be abolished, and the two most senior members shall join the District Board, which shall then act for the bank. If the District Board has been terminated, it shall take the concurrent abolition referendums of two banks in the District to reestablish it. In order for there to be sufficient time for a change in corporate governance under this section to be assessed by the stockholders, the creation of a separate board or its abolition shall last at least five years. During the existence of a separate Board of Directors for a bank, that Board shall exercise all of the powers granted to that bank under Section 1.4, 2.1, or 3.1 of the Farm Credit Act of 1971, whichever is applicable. The District Board shall not act for the bank or impose the authority otherwise granted under Section 5.6 of the Farm Credit Act of 1971.

TITLE IX--MANDATORY COOL-OFF PERIOD FOR MERGERS

Section 901 provides for a cooling-off period for association mergers by adding a new subsection to Section 4.12 of the Farm Credit Act of 1971. A vote of voluntary merger by stockholders of two or more associations shall not take effect for sixty days, and the associations shall be held separate for that time. If a petition for reconsideration, signed by at least five percent of stockholders of any one or more of the merging associations, is presented to the supervising bank by the fiftieth day, a special stockholders' meeting to consider the merger shall be held before the sixtieth day. The special meeting shall include the stockholders of all merging associations. If a majority of the stockholders of any merging association votes against merger at the special meeting, the merger shall not take place.

TITLE X--FUNDING CORPORATION REPORT

Section 1001 adds a new Section 4.26 to the Farm Credit Act of 1971 to require the Federal Farm Credit Banks Funding Corporation to make an annual written report to each System bank and association detailing its bond placements, budget, costs and expenses. Copies of this report shall be furnished to the Agriculture Committees of the Senate and the House of Representatives, and to the Farm Credit Administration.

FARM CREDIT RELIEF, REFORM AND LOCAL CONTROL ACT OF 1987

TITLE I -- INTEREST RATE REDUCTION

TITLE II -- BORROWER RELIEF: FORBEARANCE AND RESTRUCTURING

TITLE III -- BORROWER RIGHTS

TITLE IV -- UNIFORM USE OF REGULATORY ACCOUNTING

TITLE V -- SUNSET OF THE CAPITAL CORPORATION AND HALT TO SYSTEM CENTRALIZATION THROUGH SERVICE ORGANIZATIONS

TITLE VI -- FUTURE STABILITY THROUGH FARM CREDIT RESERVE FUND

TITLE VII -- TERMINATION OF LOSS SHARING THAT CONFLICTS WITH THE RESERVE FUND

TITLE VIII -- LOCAL CONTROL

TITLE IX -- MANDATORY COOL-OFF PERIOD FOR MERGERS

TITLE X -- FUNDING CORPORATION REPORT

A BILL

To amend the Farm Credit Act of 1971 to provide Farm Credit System stockholder/borrowers with a multi-point program of relief and reform, and to assure the long-term health and stability of Farm Credit banks and associations through local control.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE

This Act may be cited as the "Farm Credit Relief, Reform and Local Control Act of 1987".

TITLE I--INTEREST RATE REDUCTION

SEC. 101. IMMEDIATE INTEREST RATE REDUCTION.

There shall be a mandatory reduction in the billing rate on all Farm Credit System loans, starting on the date of enactment of this Act and lasting for two years. This mandatory reduction shall apply to loans outstanding on the date of enactment of this Act and to new loans, and shall be composed of contributions from the Treasury of the United States, from System lenders and from System borrowers, as set forth below. It shall be in addition to any voluntary rate reduction by any lending institution.

(a) Federal Contribution.--There shall be a two percentage point reduction which shall be funded by direct payments from the Secretary of the Treasury to each Farm Credit System lender, as soon as practicable after the end of each financial quarter, equal to the amount by which interest payments on loans held by that lender were reduced by operation of this paragraph.

(b) System Contribution.--There shall be a one percentage point reduction which shall be funded by each Farm Credit System lender with respect to its loans. Any interest rate reductions made by a lender from January 1, 1987 through the effective date of this Act shall be counted toward this one percentage point reduction, and any interest rate increases made during that period shall be removed.

(c) Borrower Contribution.--There shall be a two percentage point reduction to be funded by applying up to one-half of each borrower's stock, as allocated to each of his or her loans, against interest that the borrower would owe but for the reduction contained in this paragraph. The reduction contained in this paragraph shall terminate with respect to a loan sooner than the general rate reduction mandated by this section if the stock credit allocable to that loan is exhausted. Crediting borrower stock against interest shall decrease a lender's capital account and be reported as interest income by the lender and as interest expense by the borrower, while decreasing the amount owed to the borrower upon redemption of his or her stock.

(d) Temporary Guarantee of Borrower Stock.- For a period of five years starting on the effective date of this Act, no borrower stock shall be retired at less than par, as guaranteed under section 601 of this Act.

TITLE II--BORROWER RELIEF: FORBEARANCE AND RESTRUCTURING

SEC. 201. BORROWER RELIEF THROUGH FORBEARANCE PROGRAM, FORECLOSURE RESTRICTIONS, LEASE-BACK BUY-BACK PROGRAM, HOMESTEAD.

Title IV of the Farm Credit Act of 1971 is amended by adding a new Part at the end as follows:

"PART G--FORBEARANCE; FORECLOSURE RESTRICTIONS; LEASE-BACK BUY-BACK; HOMESTEAD

"Sec. 4.40. FORBEARANCE PROGRAM.--All banks and associations shall have a forbearance program that provides at least the borrower forbearance opportunities contained in this section.

"(a) On the written request of a borrower with respect to a loan that is about to become, or is, delinquent, a bank or association shall determine whether the borrower meets the following forbearance criteria:

"(1) the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations,

"(2) the borrower has the financial capacity and the management skills to protect the collateral from diversions, dissipation or deterioration, and

"(3) the borrower is capable of working out his or her existing financial difficulties, re-establishing a fully viable operation and repaying the loan on a rescheduled basis.

"(b) For borrowers meeting the forbearance criteria, the bank or association shall consider whether any of the following actions would both benefit the borrower and offer reasonable protection for the institution:

"(1) formal or informal agreement to a late payment or payments;

"(2) deferral for some period of the payment of all or part of the principal otherwise due;

"(3) extension of the term of the loan through reamortization; or

"(4) refraining for some period to exercise a right with respect to the loan otherwise granted by the loan documents or applicable law.

"(c) The bank or association may require the borrower to furnish appropriate financial documents and information in view of the forbearance option or options under consideration.

"(d) The borrower shall have the right within 10 days after notification of a refusal to forbear to appeal for reconsideration to a committee established by the institution's board of directors. The notification of refusal to forbear shall disclose this right. The committee may accept additional information to decide the appeal. Its decision shall be final.

"Sec. 4.41. FORECLOSURE RESTRICTIONS.--A bank or association shall not foreclose a mortgage if the borrower:

"(1) is doing his or her honest best (by exerting every reasonable effort toward proper management and operation of the security; using outside income or resources, if available, to help carry the indebtedness; and being willing to meet all material requirements which the bank and association are justified in making) and is cooperative;

"(2) is applying income, over and above necessary living and operating expenses, to the payment of primary obligations (by restricting living expenses to what is reasonable in view of the amount of indebtedness);

"(3) is taking proper care of the property (by maintaining necessary buildings and other physical assets in reasonable state of repair and in general maintaining or improving the overall condition of the property); and

"(4) has the capacity to work his or her way out of a reasonable burden of debt under normal conditions.

"Sec. 4.42. HOMESTEAD PROTECTION.--If an institution forecloses a loan made by the institution or a borrower of a loan made by the institution declares bankruptcy or goes into voluntary liquidation to avoid foreclosure or bankruptcy, the institution is encouraged to permit the borrower to retain possession and occupancy of the principal residence of the borrower, and a reasonable amount of adjoining land, to maintain the family of the borrower, through lease-back buy-back as provided in the next section or otherwise.

"Sec. 4.43. LEASE-BACK BUY-BACK PROGRAM.--To avoid displacing viable agricultural operators and depressing the value of land in the region, banks and associations shall have a lease-back buy-back program that provides at least the opportunities contained in this section.

"(a) Lease to Viable Operator With Option to Repurchase.--If a bank or association forecloses on a loan, or if a borrower declares bankruptcy or enters voluntary liquidation to avoid foreclosure or bankruptcy, the institution, after taking title to any property listed as collateral with respect to such loan, may lease all or any part of that property to--

"(1) the borrower if that borrower is a viable operator at the time the institution takes title, or

"(2) if the borrower is not a viable operator or does not desire to lease the loan collateral, to any other viable agricultural operator, giving special consideration to operators of family-size farms and to beginning farmers.

"(b) 10-Year Maximum Term.--The bank may re-execute the lease or enter into a new lease with lessees who remain viable operators, except that the bank may not retain title to the leased collateral for longer than ten years.

"(c) Repurchase Option.--If the institution leases the property to the borrower under subsection (a)(1), the lease agreement shall contain a repurchase option covering the whole or any part, exercisable at any time as agreed between the institution and the borrower, at a price to be determined at the time that the option is exercised. The option price shall not exceed the amount of loan principal outstanding when the institution took title, plus any interest that would have accrued from that date to the date of repurchase.

"(d) Certification as Bond Collateral.--The value of loan collateral to which an institution has taken title pursuant to this section may serve as bond collateral under Section 4.3(c).

"(e) Appeals.--A borrower shall have the right to appeal an institution's decisions under this section to a committee established by the institution's board of directors. The decisions of that committee shall be final.

"(f) Inapplicability to Marginal Land.--This lease-back buy-back program shall not apply to land that the bank or association believes should not be in agriculture, or to highly erodible land or converted wetland as described in sections 1211 and 1221 of the Food Security Act of 1985."

TITLE III--BORROWER RIGHT$

SEC. 301. BORROWER RIGHTS.

(a) Specification of Borrower Rights.--The title of Part C of Title IV of the Farm Credit Act of 1971 is amended to read:

"PART C--BORROWER RIGHTS"

(b) Protection of Borrowers With Current Loans From Demands for Additional Collateral or Information.--A new Section 4.21 is added to the Farm Credit Act of 1971 as follows:

"Sec. 4.21. BORROWER PROTECTION.--A Farm Credit System borrower may not, with respect to any loan that is current under the terms of the loan agreement:

"(a) be required to provide additional collateral;

"(b) be foreclosed on or otherwise liquidated for failing to post additional collateral; or

"(c) be required to furnish additional financial information unless the borrower is requesting a change in the terms in the loan agreement."

(c) Access to Documents and Information.--Section 4.13A of the Farm Credit Act of 1971 (12 U.S.C. 2200) is amended to read as follows:

"Sec. 4.13A. ACCESS TO DOCUMENTS AND INFORMATION.--System institutions shall provide their borrowers, at the time of execution of loans and at any time thereafter upon request:

"(a) copies of all documents signed or delivered by the borrower; and

"(b) a copy of the institution's articles of incorporation or charter and bylaws."

SEC. 302. JURISDICTION OF BORROWERS' SUITS; STANDING.

A new Section 5.38 is added to the Farm Credit Act of 1971 as follows:

"Sec. 5.38. BORROWERS' SUITS.--(a) Right of Action.--Any borrower shall have a right to sue

"(1) any institution of the Farm Credit System for violation of

"(A) any duty, standard or limitation owing to the borrower, prescribed under this chapter, and

"(B) any order issued by the Farm Credit Administration with respect to any such a duty, standard or limitation owing to the borrower, and

"(2) the Farm Credit Administration for a failure to perform any act or duty prescribed under this chapter to the extent that it is not discretionary.

"(b) Jurisdiction.--The United States district courts shall have original jurisdiction, without regard to the amount in controversy or the citizenship of the parties, over any action brought under subsection (a).

"(c) Standing.--A borrower shall have standing if he or she has suffered legal wrong or is aggrieved or adversely affected by the violation or violations on which the suit is based.

"(d) Other Causes of Action.--Nothing in this section shall restrict any right which any borrower or any other person (or class of borrowers or other persons) may have under this Act, any other statute or the common law."

TITLE IV--UNIFORM USE OF REGULATORY ACCOUNTING

SEC. 401 FINANCIAL RELIEF THROUGH UNIFORM REGULATORY ACCOUNTING.

(a) Amortization of Excess Loan Loss Reserves.--The third sentence of Section 5.19(b) of the Farm Credit Act of 1971 (12 U.S.C. 2254(b)) is amended to read as follows:

"For the years 1986 through 1988, each bank of the System shall capitalize its additions to its provision for losses in excess of one-half of one percent of loans outstanding, shall amortize those amounts over a period of twenty years, and shall prepare financial reports on this basis."

(b) Amortization of Excess Interest Costs.--Section 4.8(b) of the Farm Credit Act of 1971 (12 U.S.C. 2158(b)) is amended to read as follows:

"For the years 1986 through 1988, each bank of the System shall capitalize its interest costs in excess of 6.0 per cent on all individual, joint and System-wide obligations, and shall amortize those amounts over a period of twenty years."

TITLE V--SUNSET OF THE CAPITAL CORPORATION AND HALT TO SYSTEM CENTRALIZATION THROUGH SERVICE ORGANIZATIONS.

SEC. 501. SUNSET OF THE FARM CREDIT SYSTEM CAPITAL CORPORATION

(a) Sunset--Section 4.28G(b)of the Farm Credit Act of 1971 (12 U.S.C. 2216f(b)) is amended to read as follows:

"The authority and existence of the Farm Credit System Capital Corporation shall terminate on the ninetieth day after the effective date of the Farm Credit Relief, Reform and Local Control Act of 1987."

(b) Liquidation; Distribution of Proceeds. -- The Farm Credit System Capital Corporation shall be liquidated as soon as practicable after termination, and its assets shall be distributed among Farm Credit System institutions that contributed to its funding under section 4.28G(a)(14) in proportion to their contributions. Distributions shall be decreased by amounts already received as financial assistance or otherwise already returned.

(c) Conforming Amendment.-- Section 4.1 of the Farm Credit Act of 1971 (12 U.S.C. 2152) is deleted.

SEC. 502. HALT TO SYSTEM CONSOLIDATION OR MERGER THROUGH SERVICE ORGANIZATIONS SUCH AS THE FARM CREDIT CORPORATION OF AMERICA.

(a) The service organizations sections of the Farm Credit Act of 1971, sections 4.25 through 4.28 (12 U.S.C. 2211 through 2214) are deleted. A new section 4.25 is added as follows:

"Sec. 4.25. CHARTERING OF SERVICE ORGANIZATIONS PROHIBITED. --The Farm Credit Administration shall not have the power under this or any other Act to charter any entities except Federal land banks, Federal land bank associations, Federal intermediate credit banks, production credit associations, banks for cooperatives, the Central Bank for Cooperatives, and the Federal Farm Credit Banks Funding Corporation."

(b) All service organizations established pursuant to section 4.25 of the Farm Credit Act of 1971 (12 U.S.C. 2211) before the effective date of this Act, except the Federal Farm Credit Banks Funding Corporation, shall be liquidated within ninety days after the effective date of this Act.

The Federal Farm Credit Banks Funding Corporation shall retain its function of assisting in the issuance of systemwide obligations, and continue as a body corporate. The Federal Farm Credit Banks Funding Corporation shall have no authority to extend credit, to set policy, to prescribe lending limits or standards, to make any lending decisions, to hold any primary System capital, to assume in any manner the primary responsibility of System institutions to service System borrowers, or to provide insurance services for borrowers from System institutions.

SEC. 503. CONFORMING AMENDMENT.

Section 1.2 of the Farm Credit Act of 1971 (12 U.S.C. 2002) is amended to read as follows:

"Sec. 1.2. THE FARM CREDIT SYSTEM.--The Farm Credit System shall consist of the Federal land banks, the Federal land bank associations, the Federal intermediate credit banks, the production credit associations, the banks for cooperatives, the Central Bank for Cooperatives, and the Federal Farm Credit Banks Funding Corporation.".

TITLE VI--FUTURE STABILITY THROUGH FARM CREDIT RESERVE FUND

SEC. 601. IMMEDIATE AUTHORIZATION OF THE FARM CREDIT RESERVE FUND

Section 4.9A of the Farm Credit Act of 1971 (12 U.S.C. 2161) is amended to read as follows:

"Sec. 4.9A. RESERVE FUND FOR THE FARM CREDIT

SYSTEM.--(a) Establishment.--The Farm Credit Administration shall establish a reserve fund (referred to in this part as "the Reserve") within 30 days after the effective date of the Farm Credit Relief, Reform and Local Control Act of 1987, and maintain it in accordance with this section.

"(b) Investment.--The Reserve shall be held solely in Treasury securities, demand deposits and such other investments as are guaranteed as to principal and interest by the United States.

"(c) Use of Reserve Funds.--

"(1) Temporary Guarantee of Borrower Stock.--For a period of five years starting on the effective date of the Farm Credit Relief, Reform and Local Control Act of 1987, the Farm Credit Administration shall make such payments to banks and associations from the Reserve as are necessary to prevent borrower stock from being retired at less than par.

"(2) Protect Institution Viability.--The Farm Credit Administration shall use the Reserve to make financial assistance available to financially troubled institutions of the Farm Credit System so as to ensure that farm credit services will continue to be available to borrowers in the institution's territory.

"(d) Funding.--

"(1) Initial Funding.--

(A) One-Time Issuance of Guaranteed Bond.--The initial funding of the Reserve shall be through the one-time issuance of an uncollateralized joint obligation of the banks of the Farm Credit System in the amount of 1.5 billion dollars, which shall be guaranteed by the United States. Each bank shall be responsible for that portion of the obligation which corresponds to that bank's portion of total System assets (considering bank and association assets as consolidated for this purpose). In return, the Reserve shall issue an equivalent amount of non-voting stock in the Reserve to be held by each bank as an asset.

"(B) Liquidation Proceeds.--All proceeds from the liquidation of any corporation pursuant to section 502 of this Act shall be contributed to the Reserve.

"(2) Perpetual Funding.--The Reserve shall be maintained through the payment into it of up to 1 percent of the proceeds from each note, bond, debenture, or other obligation issued by one or more banks under this Act, as ordered by the Farm Credit Administration without the burden falling unfairly on individual banks or bank groups. Payments shall be allocated among the issuing banks in the same proportion as they receive the proceeds of the issuance, and shall be accounted for as operating expenses.

"(3) Suspension of Payments.--The Farm Credit Administration shall temporarily suspend funding under paragraph (2) if the Reserve contains the lesser of:

"(A) an unobligated sum that exceeds the amount necessary to achieve the purposes of the Reserve, as determined by the Farm Credit Administration, giving due regard to the possibility of unexpected System or institution financial difficulties, or

"(B) an amount in excess of 3 percent of the total of System loans outstanding on December 31 of the preceding year made to persons other than other System institutions.

"(e) Rebate.--Reserve amounts in excess of the maintenance level established under paragraph (d) shall be rebated to banks in proportion to their contributions during the period determined by the Farm Credit Administration as having generated the excess. Rebates shall be accounted for as operating income.

"(f) Repayment of Financial Assistance.-- The Farm Credit Administration shall require a bank or association to repay any financial assistance made under this section when the Farm Credit Administration determines that the bank or association can do so and the need for financial assistance is reduced or no longer exists.

"(g) Regulations.--The Farm Credit Administration shall issue regulations implementing this section."

TITLE VII--TERMINATION OF LOSS SHARING THAT CONFLICTS WITH THE RESERVE FUND

SEC. 701. TERMINATION OF INTER-BANK AGREEMENTS IN CONFLICT WITH THE RESERVE FUND.

The statutory authority for the 37-Bank Capital Preservation Agreement, the Federal Land Banks Capital Preservation Agreement, the Federal Intermediate Credit Banks Capital Preservation Agreement and the Banks for Cooperatives Loss Sharing Agreement is abolished, and in exchange for the benefits flowing to the signatories to those agreements under the provisions of this Act, those agreements are terminated as of January 1, 1986, with any actions thereunder subsequent to January 1, 1986 being hereby reversed.

(a) Section 1.4(22) of the Farm Credit Act of 1971 is deleted;

(b) Section 2.1(18) of the Farm Credit Act of 1971 is deleted; and

(c) Section 3.1(18) of the Farm Credit Act of 1971 is deleted.

TITLE VIII--LOCAL CONTROL

SEC. 801. ELECTION TO HAVE SEPARATE BOARDS OF DIRECTORS FOR SYSTEM BANKS.

A new Section 5.3A is added to the Farm Credit Act of 1971 as follows:

"Sec. 5.3A ELECTION TO HAVE SEPARATE BOARD OF DIRECTORS FOR SYSTEM BANK.--(a) Petition; Notice.--Upon receipt of a petition by a stockholder or stockholders of any bank (or one or more borrowers from or subscribers to the guaranty fund of a bank for cooperatives) representing at least twenty-five percent of the total number of votes that may be cast by the bank's stockholders (or subscribers) in the election of directors, the Farm Credit Administration shall, within thirty days, issue a notice to all stockholders (or subscribers) explaining that a referendum has been called to determine whether to elect a separate Board of Directors for the bank. The notice shall state the time and place of a special stockholders' meeting to hold the referendum. The notice to associations shall state the number of votes that the board of the association is entitled to cast in the referendum, based on the number of voting stockholders of that association on the date of such notice, as determined by the Farm Credit Administration. The meeting shall be held not less than thirty nor more than sixty days from the date on which the notice is mailed.

"(b) Majority Vote.--If at the special stockholders' meeting called pursuant to subsection (a) a majority of the votes represented at such meeting are cast in favor of the election of a separate Board of Directors for the bank, the Farm Credit Administration shall proceed to hold elections for a separate Board of Directors for the bank in accordance with the provisions of subsection (c).

"(c) Separate Bank Board of Directors.--Each separate Board of Directors shall be composed of five members. Two members of the original separate board shall be the two District board members already elected by the bank's stockholders (or subscribers), who shall no longer be members of the District Board. The other three original members, and all succeeding members, shall be elected and serve in accordance with Sections 5.1 and 5.2.

"(d) Termination of District Board.--If separate boards are established for two or more banks in a District, the District Board for that District shall be terminated.

"(e) Coordination With Other Boards.--Coordination between boards of directors in a District on matters such as joint property, functions or policy shall be by committee composed of representatives from each board in the District.

"(f) Abolishment of Separate Boards.--A separate Board of Directors established pursuant to this section shall continue until abolished. If the Farm Credit Administration receives a petition similar to that described in subsection (a) requesting a referendum to determine whether to retain the separate Board of Directors for the bank, a referendum shall be held as provided in subsection (a). If a majority of the votes represented at the special shareholders' meeting called pursuant to the preceding sentence are cast in favor of abolishing the separate Board of Directors of the bank, the Board shall be abolished, and the two most senior members shall join the District Board, which shall then act for the bank. If the District Board has been terminated under subsection (d), it shall take the concurrent abolition referendums of two District Banks to reestablish it.

"(g) Limitation.--The creation of a separate board, or its abolition, shall last at least five years.

"(h) Powers.--The separate board of directors of a district bank elected pursuant to this section shall have the power to exercise all of the powers granted to the bank in section 1.4, 2.1, or 3.1, whichever is applicable. The District Board shall not act for the bank or impose the authority otherwise granted under Section 5.6."

TITLE IX--MANDATORY COOL-OFF PERIOD FOR MERGERS

SEC. 901. COOLING-OFF PERIOD FOR ASSOCIATION MERGERS.

Sec. 4.12 of the Farm Credit Act of 1971 (12 U.S.C. 2183) is amended by adding at the end thereof the following:

"(d) A vote of voluntary merger by stockholders of two or more associations under subsection (a) shall not take effect for sixty days, and the associations shall be held separate for that time. If a petition for reconsideration, signed by at least five percent of the stockholders of any one or more of the merging associations, is presented to the supervising bank by the fiftieth day, a special stockholders' meeting to reconsider the merger shall be held before the sixtieth day. The special meeting shall include the stockholders of all merging associations. If a majority of the stockholders of any merging association votes against merger at the special meeting, the merger shall not take place."

TITLE X--FUNDING CORPORATION REPORT

SEC. 1001. REPORT BY THE FEDERAL FARM CREDIT BANKS FUNDING CORPORATION.

A new Section 4.26 is added to the Farm Credit Act of 1971 as follows:

"Sec. 4.26. FUNDING CORPORATION REPORT.--The Federal Farm Credit Banks Funding Corporation shall make an annual written report to each System bank and association detailing its bond placements, budget, costs and expenses. Copies of this report shall be furnished to the Agriculture Committees of the Senate and the House of Representatives, and to the Farm Credit Administration."

STATEMENT OF JOHN C. DEAN, PRESIDENT, GLENWOOD STATE BANK, GLENWOOD, IA AND CHAIRMAN, AGRICULTURE-RURAL COMMITTEE, INDEPENDENT BANKERS ASSOCIATION OF AMERICA AND JACK DICKEY, PRESIDENT, FIRST NATIONAL BANK, THOMAS, OK AND VICE CHAIRMAN, AGRICULTURE-RURAL COMMITTEE, IBAA

Mr. Chairman and Members of the Subcommittee, I am John Dean, President of the Glenwood State Bank in Glenwood, Iowa, and Chairman of the Agriculture-Rural Committee of the Independent Bankers Association of America. With me is Jack Dickey, President of the First National Bank in Thomas, Oklahoma, and Vice-Chairman of IBAA's Agriculture-Rural Committee.

We appreciate this opportunity to express our views as you are developing farm credit legislation.

One issue not under the jurisdiction of this Committee, but with which we are very concerned, is the need to close the nonbank bank loophole in the legislation currently pending before the Senate, S. 790. We urge your support for that legislation.

We are very interested in the farm credit legislation that you are developing. Resolving the issues dealing with the Farm Credit System per se is primarily the responsibility of farm borrowers, the Farm Credit institutions, the FCA as regulator, and, of course, you in Congress and the Administration. However, two major issues of financial assistance and restructuring can greatly affect agricultural banks' ability to serve farm borrowers.

Any outside financial assistance for the Farm Credit System should be considered in a legislative package that provides equality of treatment for other lenders serving farmers and agriculture areas. Agricultural banks, such as my bank in Western Iowa and Jack Dickey's bank in western Oklahoma, are just as committed to agriculture and the family farmers as any other lending institution that operates in our region. Equality of treatment does not mean that exactly the same measures should be enacted for Farm Credit banks and other agricultural lenders. However, the legislative package that you put together should deal fairly with farm customers of both the Farm Credit System and the commercial agricultural banks.

In considering the potential restructuring of the Farm Credit System towards greater centralization or decentralization, moving in the general direction of decentralization may be preferable. Greater decentralization of control and responsibility in the local Farm Credit institutions should best protect borrowers' rights and interests, and it will also resist the trend toward greater concentration among financial institutions. Emphasizing decentralization will not prevent uniformity in certain specific areas. For instance, it would still be possible to provide for uniform underwriting standards for loans offered for sale to investors through a secondary market.

I would like to respond to a concern of agricultural lenders in the legislative package that you are developing. Specifically, we recommend that provisions for a secondary market for fixed-rate, long term farm real estate loans be included, and we are prepared to work with this Committee and staff to incorporate secondary market provisions and expedite the enactment of this legislative package.

All agricultural lenders—whether Farm Credit banks, commercial agricultural banks, life insurance companies, or others—should have available the modern instrument of a secondary market, based upon the securitization of farm mortgages. A secondary market can provide the means for diversifying and spreading of financial risks and returns to general investors. The legislation that you are developing is the proper place to do that. A farm mortgage secondary market is first and foremost an agricultural arrangement designed to bring better credit service to farmers.

Farm borrowers would benefit from the operation of a farm mortgage secondary market, by having access to cheaper mortgage money at fixed rates of interest. A home buyer can lock in a 25-year fixed-rate mortgage because Fannie Mae and Freddie Mac enable institutions to pass through some of the risks and returns to investors, who in turn can freely exchange their interests in those mortgages. A farmer who purchases farmland should have the option of getting a fixed-rate mortage. He could, if a similar secondary market for farm mortages is created.

Our work on the secondary market issue during the past two years has included meetings with investment bankers; officials of Ginnie Mae, Fannie Mae, and Freddie Mac; the Departments of Agriculture and Treasury; the bank regulatory agencies and Farm Credit Administration, and others. Beginning on December 9, of last year, five joint meetings have been held involving representatives of the Farm Credit System, American Bankers Association, National Council for Life Insurance, and IBAA. The meetings were held December 9, 1986, and January 13, February 10, February 24 and March 24 of this year. Those joint meetings have worked on both the development of loan underwriting standards and structure for an agricultural secondary market.

Through this series of joint meetings, we have identified specific elements of a secondary market that have broad acceptability. Although agreement among the lenders remains tentative in some respects, we have identified such elements as: (1) a single organizational focus for administering loan underwriting standards, certifying institutions to pool and market packages of farm mortgages, and providing the credit enhancement for pools of mortgages; (2) provision for institutions from both within and outside the Farm Credit System to be certified as loan poolers and marketers; (3) a liquid reserve fund, to be established for each pool of loans from contributions by loan originators and poolers, that would be available to absorb losses on loans in the pool before any credit enhancement would be at risk. Such a reserve would be maintained in an amount equal to ten percent of the unpaid principal value of loans in a particular pool.

Despite some remaining issues, in our judgment the joint discussions among lenders have progressed to the point that remaining issues can and should be resolved within a time frame that allows the secondary market arrangement to be authorized in the farm credit legislation that you are developing. A bill being introduced today by Senators Exon and Grassley should be helpful. That Agricultural Mortgage Marketing Bill captures quite well the elements of tentative agreement among the Farm Credit System and other lenders, offers practical means for resolving the remaining issues, and with refinements can provide a focus for action by your Committee.

I want to highlight one feature of the Exon-Grassley bill that we believe is especially significant. The Federally-chartered corporation authorized by that bill (called the "Agricultural Mortgage Enhancement Corporation") is established within the Farm Credit System to allow the secondary market arrangement to operate under a single umbrella, but that corporation is capitalized separately from the capital of the 37 existing banks of the Farm Credit System. The secondary market would neither incur financial liabilities from any of the Farm Credit Banks, nor obligate the capital of any of those banks. Therefore, the functioning of the secondary market arrangement should not be adversely affected if Congress decides to move in the direction of decentralizing the Farm Credit System by giving more control and responsibility to local Farm Credit institutions. In addition, since the individual Farm Credit banks' capital need not be placed at risk behind the mortgages that are pooled for the secondary market, Congress should be able to move with less concern about adversely affecting the capital position of the Land Banks or other Farm Credit banks.

The volume of farm mortgages channelled through the secondary market would expand only gradually. The secondary market should work in the positive direction of improving farmers' access to mortgage credit on better terms and strengthening the value of farmland.

Mr. Chairman, we believe that we have come a long way on the secondary market issue, from discussing general concepts a couple of years ago to achieving a major degree of consensus on a specifically structured secondary market arrangement. This should enable the authorization for the secondary market arrangement to be included in the farm credit legislation that you are developing in this Committee. We wish to work with you to that end, for the benefit of our farm customers.

This concludes my statement, and I will be pleased to respond to any questions.

STATEMENT OF ROBERT W. RANGER AND PAUL E. LINDHOLM ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and Members of the Senate Subcommittee on Agricultural Credit: I am Robert W. Ranger, Senior Vice President, Norstar Bank of Upstate New York, Utica, New York. Accompanying me today is Paul E. Lindholm, Chairman and Chief Executive Officer, Farmers and Merchants State Bank, Clarksville, Minnesota. I am this year's Chairman of the American Bankers Association's (ABA) Agricultural Bankers Division Executive Committee and Mr. Lindholm is the Vice Chairman. We are both pleased to be able to testify today on behalf of the American Bankers Association.

Our Association is the largest national banking trade association. The combined assets of our members comprise about 95 percent of the total assets of the commercial banking industry. While our members range in size from the smallest to the largest banks, about 85 percent have assets of less than $100 million. Using the standard definition of agricultural bank utilized by the Federal Reserve and Federal

Deposit Insurance Corporation (FDIC) as a bank with at least 25% of total loans in loans to agriculture, 3,795 of the nation's banks were considered agricultural banks as of September 30, 1986.

Mr. Chairman, the members of ABA are very concerned about the extent of financial distress in the agricultural economy. It is affecting farmers, agricultural banks and the Farm Credit System (FCS). Banks are deeply involved in agriculture. According to a Federal Reserve Board study, banks had $43.9 billion outstanding to agriculture as of December 31, 1986 compared to the FCS $48.7 billion.

We shall present a brief overview of the problems of agricultural banks, discuss some of our concerns about the Farm Credit System, and propose a secondary market for agricultural real estate as one means of assisting farm borrowers and lenders in the future.

FARM BANK PERFORMANCE

The farm problems facing this country are affecting rural banks, both directly and through their depressing effect on rural economic activity. Table 1 demonstrates the deteriorating condition of farm balance sheets. The fundamental problem is the decline in farm income from agricultural production. The farmers' financial distress is having an adverse affect on agricultural banks.

DELINQUENT LOANS AND CHARGE-OFFS

Delinquency rates on agricultural production loans increased substantially from 1.73 percent at the end of 1984 to 7.72 percent by the middle of 1986.

The proportion in nonaccrual status (loans on which banks are not receiving interest) had risen in every quarter from 1.49 percent in December 1984 to 5.97 percent in June 1986. Much of the upward trend in delinquency rates consisted of increases in nonaccrual loans.

Total charge-offs of loans at agricultural banks have gone from 2.28 percent in December 1984 to 3.92 percent by June 1986. (There was a slight decrease from the 1985 level).

PROFITABILITY OF AGRICULTURAL BANKS

Increases in loan losses and non-performing loans have adversely affected the net income of agriculural banks. During the 1970's, loan losses were very low. The proportion of agricultural banks reporting negative earnings began to rise in the early 1980's, reaching 129, in 1982 and 729 in 1986 (Chart 1). Return on equity fell from 13.2 percent in 1982 to 6.65 percent in 1986.[1] The provision for loan losses, which has been a significant factor in the lower profitability of agricultural banks since 1980, has declined from 2.46 percent in 1985 to 2.06 in June 1986).

AGRICULTURAL BANK FAILURES

As recently as 1982, agricultural banks as a group still enjoyed the favorable loan experience—low delinquency rates and losses—and relatively high profits that had characterized the previous decade. Agricultural banks were underrepresented among failing banks. For example, out of the 48 bank failures in 1983, only seven were agricultural banks. However, out of the 138 bank failures that occurred in 1986, 59 were agricultural banks. Loan problems began to mount and, during 1985, failures of agricultural banks became increasingly common.

FAILED BANKS

Year	1983	1984	1985	1986	1987 [1]
Agricultural banks	7	25	62	59	15
All banks	48	79	120	138	44

[1] As of March 19, 1987.

Source: Federal Deposit Insurance Corporation.

The number of bank failures loosely parallels the rapidly increasing number of problem banks, and there has been a significant increase in the number of problem banks during the last three years, as shown below:

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[1] The figures for 1986 represent annualized rates for the first 3 quarters of the year.

PROBLEM BANKS

Year	1983	1984	1985	1986	1987 [1]
All banks	642	848	1,140	1,457	1,500

[1] As of March 19, 1987.

Source: Federal Deposit Insurance Corporation.

Unfortunately, the FDIC does not keep separate data on problem agricultural banks. However, if the trends of the past three years continue, bank failures will increase, tracking the increase in problem banks.

COOPERATIVE FARM CREDIT SYSTEM

The financial difficulties of the Farm Credit System have been receiving much public attention in the past several months. We know that this committee is very much concerned with the question of how the problems of the System can be addressed to protect the farmers who rely on it. We are also certain that the committee wishes to ensure that those farmers can receive credit at competitive rates.

The ABA wants to work with the members of this committee to guarantee that all providers of agricultural credit and the farmers who borrow from them are treated fairly in this period of severe financial distress. If any agricultural lending institution is assisted in a manner that unduly advantages it over its competitiors, it will make it much more difficult for farm borrowers to receive credit at competitive rates in the future.

Therefore, Mr. Chairman, we want to discuss several general issues that we believe will be considered by the committee as it reviews the FCS' current situation: regulatory structure, risk capital, loan-to-appraised value of real estate, pricing policies, and proposals to centralize the System's structure.

Mr. Chairman, while bankers sometimes complain about our regulators, we also know that they are an important component of the mechanism ensuring the safety and soundness of the banking industry. Therefore, we commend this committee and the Congress for the action taken in the Farm Credit Amendments Act of 1985 to turn the Farm Credit Administration into an independent regulator.

Frequent examinations and careful regulatory standards are necessary to ensure the safety and soundness of lending institutions. While we may have problems with individual regulations, we continue to support the independent banking regulatory agencies. A strong and independent FCA will help protect the safety and soundness of the FCS.

However, for FCA to be truly effective regulator, there must be some "risk capital" in the System. The System's capital structure is a very important issue in both a business and political sense. Of the $5.6 billion of total capital FCS had in December, 1986, $1.5 billion was surplus and $4.1 billion was capital and "participation certificates." (Table 2). Most of the latter is a form of common stock each borrower is required to purchase as a condition of getting a loan.

The question of whether the borrowers' stock is at risk is a very sensitive political issue. While it is clear that the stock is legally at risk, the negative reaction to impairing it may mean that, as a practical matter, it is not really "risk capital."

If the stock is not at risk, the System is undercapitalized, leaving the Federal Treasury very much at risk. In addition, if it is not at risk, the stockholders have no stake in preserving a safe and sound system. If the $4.1 billion worth of capital represented by the stock cannot be touched, that leaves the System with only $1.5 billion worth of surplus to cover any future losses.

This represents only 25.8% of the $4.1 billion of total capital, down from 43.61% in 1983 (Table 3).

If borrower stock is not at risk, then the true capital situation of FCS is significantly weaker than it would at first appear. Further, if the stock is not at risk, then the capital ratios of farm banks were almost twice as high as those of the FCS in 1983, and had climbed to almost 4.5 times as much by 1986 (Table 3).

It is this capital that gives bank stockholders a very personal interest in the safety and soundness of the banks. It is also a tool that the regulators can use if they determine that action must be taken to correct a situation in a bank. Banks' capital is at risk, if the regulator determines that it is necessary. If, for political reasons, most of the FCS capital is not at risk, then the internal pressure for a safe and sound system breaks down and the Federal "backstop" is much more threatened because the institution may adopt risky practices and not have a built.in capital "shock absorber."

The System has pursued risky practices in the past, sometimes encouraged by public policy. The Farm Credit Act of 1971 raised the loan-to-appraised value limit from 65% to 85% for real estate. The System exercised this flexibility. Such high levels of borrowing for land contributed to the problems the System now experiences. Because land values have deflated so rapidly, the Federal Land Banks do not have sufficient collateral for their loans.

Another practice that must be prevented from occurring again is the use of average cost pricing. In an effort to increase market share, the System averaged the cost of their bonds when interest rates went up in the 1970's. In essence, the System gave away its capital for market share. Now that interest rates have dropped, commercial banks, who used marginal cost pricing, have seen their rates again become competitive.

Mr. Chairman, farmers, banks and the FCS would all be better off today had neither of these two risky practices been followed in the past.

Banks welcome competition, but it must be fair competition. Without a strong, independent regulator with risk capital in a reserve as leverage, the practices of this cooperative lending institution can easily become risky. For agricultural banks, such competition is not fair.

Finally, on the structure of the System, the ABA strongly supports the feeling of most of the farmer borrowers represented by their associations at your February 26 hearing. It was the general consensus that the System should remain decentralized. We agree. There may be changes to the System that are appropriate, but the ABA is very much opposed to the proposals for centralization.

SECONDARY MARKET FOR AGRICULTURE REAL ESTATE

The ABA has made the development of a secondary market for agriculture real estate a very high priority. We believe that, properly structured, such a secondary market will be beneficial for farmers, banks and the FCS.

The advantages of a secondary market for borrowers results from the fact that these markets are very efficient mechanisms for matching investors with borrowers. Borrowers get the terms they want (long term fixed rate loans, for example) while investors get reliable long-term investments which themselves have a liquid market.

For lending institutions, a secondary market permits the originating lender to provide customers with a desirable product while also remaining liquid and avoiding loan limit problems because the loans can be sold in the secondary market. The lenders can retain the loan servicing and their relationship with their customer.

Mr. Chairman, the ABA is pleased to state that we are working with the American Council of Life Insurance (ACLI), the Independent Bankers Association of America (IBAA) and the FCS to develop a secondary market affiliated with the System. We are involved in this effort because we believe that it would benefit all of the parties involved.

The System would gain: (1) fee income from selling the credit enhancement associated with its agency status, (2) a new desirable product of farmers (fixed rate mortgages), and (3) an opportunity for a better mix between its loans and its bonds. Banks would gain a new product in which they are now limited due to the lack of a long term source of funds or a secondary market. Banks also would be able to diversify risk. Insurance companies and other "poolers" of mortgages, gain a liquid market in securities backed by farm mortgages, thus inducing them to remain involved in agriculture. Farmers gain fixed rate mortgages at competitive rates.

Briefly, the ABA conception of this secondary market would have an entity affiliated with the FCS Funding Corporation that has a policy-making body equally divided between FCS and non-FCS users with several public members as well. This entity would adopt underwriting standards, certify loan poolers, and authorize the use of FCS' credit enhancement for pools of mortgages that meet the standards. The poolers would pay FCS for the credit enhancement.

Loan originators would sell loans that meet the underwriting standards to any certified pooler. (The FCS could both originate, buy, pool and hold loans or pools).

Farmers would have more sources of long-term financing at competitive rates. The System could both make fee income and sell a new product. Banks could provide a new product to their farmer borrowers.

Mr. Chairman, we are very involved in this project and these negotiations with the other groups. We look forward to continuing to work with them to develop a legislative proposal that we can present to you for your consideration.

CONCLUSION

In conclusion, Mr. Chairman, the situation is very difficult in the agricultural economy. We urge you to remember that it is difficult for everyone: farmers, bankers, FCS staff, all others involved in farming. As you consider your response to the FCS situation, we ask that you do not adopt policies which unduly advantage one sector. Rather, we urge you to look to the future and seek to create a response that will help us avoid some of these problems by building market discipline into our institutions. One major reason for our support of the secondary market is that it contributes to competition. Competition will be good for everyone.

Mr. Chairman, the ABA looks forward to continuing to work with you and the members of your committee.

TABLE 1.—FARM BALANCE SHEET EXCLUDING OPERATOR HOUSEHOLDS ON DECEMBER 31

[In billions of dollars]

	1982	1983	1984	1985	1986 [1]	1987 [2]
Assets:						
Real Estate	745.6	736.1	639.6	559.6	509	474
Nonreal Estate	232.2	220.3	216.4	211.9	197	195
Total assets	977.8	956.5	856.1	771.4	707	669
Liabilities:						
Real Estate	101.2	103.7	102.9	97.3	92	89
Nonreal Estate	102.4	98.8	96.0	94.8	94	86
Total Liabilities	203.6	202.4	198.7	192.1	186	175
Proprietors Equity	774.2	754.0	657.3	579.3	520	494
Debt-Asset Ratio (Percent)	20.8	21.2	23.2	24.9	26.4	26.1

[1] Preliminary.

[2] Forecast.

Source: "Economic Review," Federal Reserve Board of Kansas City, December, 1986.

TABLE 2.—FARM CREDIT BANKS COMBINED BALANCE SHEET 1979 THROUGH 1986

[In thousands of dollars]

Year	Total assets	Capital stock and participation certificates	Surplus	Total capital
1979	59,842,537	3,180,316	1,879,289	5,059,605
1980	71,623,401	3,849,735	2,339,907	6,189,642
1981	82,548,840	4,563,926	2,902,282	7,466,208
1982	85,158,735	4,979,367	3,598,354	8,577,721
1983	85,049,637	5,058,040	3,911,341	8,969,381
1984	84,831,538	5,140,829	4,101,520	9,242,349
1985	79,832,505	4,969,154	3,400,637	8,369,791
1986	70,074,——	4,188,——	1,453,——	5,641,——

Sources: "Farm Credit Banks Report to Investors," 1980 through 1984 and Farm Credit System Funding Corporation.

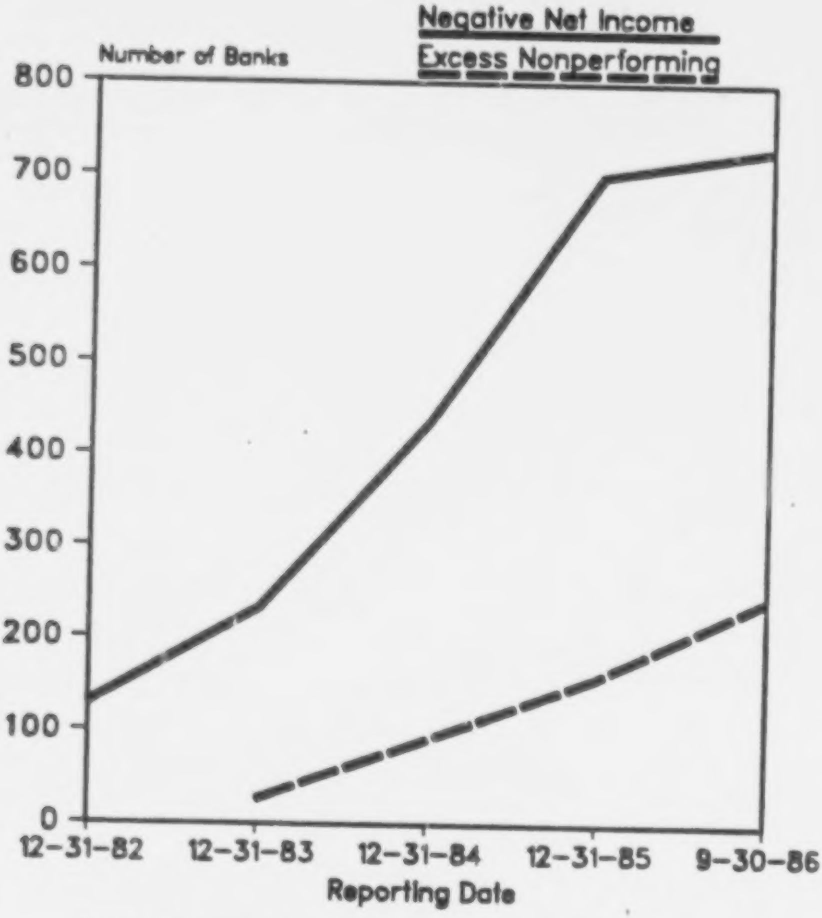
TABLE 3.—CAPITAL RATIOS OF THE FARM CREDIT SYSTEM AND AGRICULTURAL BANKS

	1983	1984	1985	1986
FCS total capital as a percent of assets	10.55	10.89	10.48	8.05
FCS surplus as a percent of total capital	43.61	44.38	40.63	25.76
FCS surplus as a percent of assets	4.60	4.83	4.26	2.07
Farm banks' capital as a percent of assets	8.96	8.95	9.03	9.16

Sources: "Farm Credit Banks Report to Investors," 1980 through 1984 and Farm Credit System Funding Corporation.
Consolidated Reports of Condition and Income Submitted to the FDIC.

CHART 1

FDIC-Insured Farm Banks with Negative Net Income and with More Nonperforming Loans than Capital



Note: Net income is measured from January 1 to the date provided in the same year.

STATEMENT OF THE
AMERICAN COUNCIL OF LIFE INSURANCE

Before the

SENATE SUBCOMMITTEE

on

AGRICULTURAL CREDIT

on

FARM CREDIT

PROPOSALS

March 26, 1987

Statement Made By:

John W. Ball
Vice President, Agricultural Investments
MONY Financial Services, Inc.

Mr. Chairman and Members of the Subcommittee, I am John W. Ball, Vice President - Agricultural Investments, MONY Financial Services, Inc. The following testimony is submitted on behalf of the American Council of Life Insurance ("ACLI"). The ACLI is a trade association with a membership of 629 life insurance companies. In the aggregate, these companies account for approximately 95 percent of the life insurance in force in the United States and hold 96 percent of the assets of insured pension plans.

The life insurance industry has long been a provider of mortgage financing to agriculture. Many of the companies providing capital to agriculture today have been doing so for more than a century. The life insurance industry currently has approximately $11 billion in mortgages secured by farmland.

Farm mortgages make a positive contribution to a well balanced investment portfolio. It is our desire to continue that investment experience and to utilize our staff and extensive service organizations, which have been carefully developed over the past century, to provide capital to agriculture on competitive terms. The life insurance industry has a successful record of perseverance and dependability as a farm mortgage lender through good times and bad.

Investment in American agriculture by commercial lenders has always provided much needed benefits for farm and ranch borrowers.

The insurance industry has taken the risks and enjoyed the rewards of farm and ranch lending; however, like everyone else in this business, we currently have our share of problems. Yet, because our overall investment portfolios are broadly diversified by investment type and industrial sector, we will withstand our current problems. Due to the experience of our staffs, most of our loan problems are resolved on an amicable basis using a variety of loan workout methods.

The prolonged, ongoing agricultural recession has created severe financial dislocations for farmers. All lenders serving them have also been adversely affected. We believe it is clear that farming and ranching have undergone fundamental change.

The focus of this hearing is the current condition and the future needs of the Farm Credit System. The Farm Credit System's deepening difficulties reflect the wrenching changes its borrowers face. The Farm Credit System is the dominant provider of short and long-term credit to farmers, ranchers, and their cooperatives. It holds 53 percent of all farm mortgages outstanding at the end of 1986.

The life insurance industry believes strongly in preserving the integrity of the Farm Credit System. We want to maintain the System in its role as a vital and reliable credit provider for farmers and as a strong competitor in the farm mortgage credit marketplace.

Farmers and lenders alike benefit from a healthy competitive environment in the agricultural mortgage lending sector.

It is precisely that belief in the primacy of a competitive marketplace for farm mortgages which brings us before this Subcommittee today. Any vision for the future financial well-being of the American farmer and rancher and the Farm Credit System must, for the welfare of all concerned, enhance the competitiveness of the entire agricultural credit delivery sector. Such a plan must include assurance of availability of alternative sources of credit for farmers and ranchers. Provisions for any Federal assistance for the Farm Credit System or view toward restructuring this dominant provider of farm loans must be undertaken within the context of overall implications on market competitiveness. The health and future viability of farmers, ranchers, and all agricultural credit providers is at stake in your deliberations.

The danger is that a disadvantageous position imposed upon commercial lenders from any new Federal initiative will discourage new sources of private-sector capital from entering the agricultural credit market. It will also encourage the exodus now underway of those insurance companies and commercial banks active in providing credit to American agriculture. Any program designed to stabilize the agricultural credit industry over the long term must seek to insure continued commercial lender participation.

To do otherwise will enure to the detriment of American farmers and ranchers.

The issue before you today is a matter of utmost public policy concern. Agriculture is a basic industry to the U.S. food and fiber system. This system accounts for 18 percent of America's gross national product and 21.3 million jobs (20 percent of total civilian employment even though only 2.6 percent are employed in production agriculture).

Access to long-term credit from a variety of competing sources is vital to America's capital-intensive farmers and ranchers. However, over the years, the farm mortgage credit market has become dominated by a single institution--the federal land bank system. As a result, farmers and ranchers are overly dependent on a single source of long-term capital. This is not to be critical of the land banks; they pursued a logical course of business given the circumstances. However, in retrospect, we can all appreciate the dangers of allowing an entire industry to rely so heavily and disproportionately on a single credit source.

This market domination, which has come about more through institutional factors rather than through freely competitive forces, poses serious economic and financial risks to farmers and to the public.

Illiquidity of farm mortgages puts long-term commercial real estate lenders, such as banks and life insurance companies, at a disadvantage in obtaining funds for mortgage lending. In contrast, the Farm Credit System's "agency status" provides it with ready access to national capital markets.

Just as American agriculture has undergone fundamental change, so too have financial systems undergone fundamental change. Changes within financial systems that serve agriculture have prompted the ACLI to ask, "what structural changes do our members, as farm mortgage lenders, have to make to continue serving agriculture effectively in the future?" And by the future, we mean not the next 60 to 600 days, but into the 21st century.

Taking this longer view, the ACLI concludes that the single most important step toward maintaining and enhancing a healthy competitive environment in farm mortgages is the establishment of a secondary market for farm mortgage loans. Just as homeowners in small communities throughout the nation have been served by the development of a secondary market for residential mortgages, farmers throughout the country will benefit from the development of a secondary market for farm mortgages. Creation of a secondary market for farm mortgages will give farmers access to a greater range of lenders and loan terms.

We appreciate the opportunity to discuss the secondary market concept within the context of your hearing today.

As some of you know, we have been active on this issue this past year. We have been meeting with the American Bankers Association, the Independent Bankers Association of America, and with representatives of farm and commodities organizations.

More recently, we, the three commercial lenders organizations represented at this hearing, have been meeting with the Farm Credit System to try to structure a secondary market through the System. We are very encouraged by the substance and the cooperative spirit of these meetings. In view of the significant progress and interest to date, we are hopeful that a workable secondary market will be achieved in the near future. Should legislation prove to be necessary to accomplish this, we would welcome the opportunity to work with you.

A secondary mortgage market acts as an intermediary which connects mortgage originators with final investors. The mortgage originators may be, among others, a life insurance company, savings and loan, commercial bank, federal land bank, mortgage company, mutual savings bank, or a credit union. The final investors may be, among others, a thrift institution, commercial bank, trust fund, pension fund, or a life insurance company.

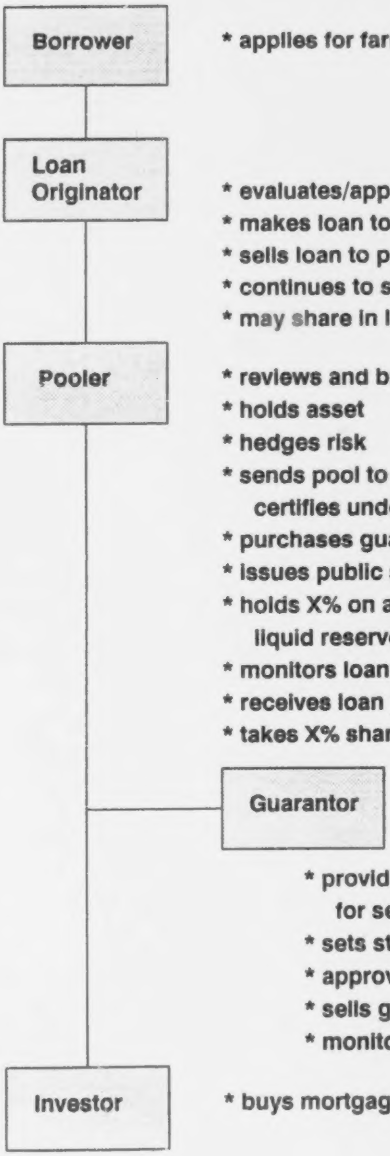
Mortgages are sold by their originators to poolers, which package them as "mortgage-backed securities" for sale to investors. By selling mortgages in a secondary market, primary mortgage lenders "reliquify" and can use the proceeds for further lending.

Existence of a secondary market allows even the smallest lender to become a participant in the larger financial community. With access to new sources of funds, a rural bank no longer has to depend solely upon its local deposit base to provide funds for its borrowers' long-term investments in farmland or Main Street businesses.

A secondary market for farm loans would mirror successful secondary market structures for home mortgages which have developed since the creation of the Government National Mortgage Association (Ginnie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Current discussions envision the creation of a secondary market for farm mortgages through an existing quasi-federal entity -- the Farm Credit System.

With proper loan underwriting standards, appropriate input from users, and an adequate coinsurance requirement for pools of farm-mortgaged-backed securities, there is almost no chance that any federal guarantee will ever be called upon. Establishment of a secondary market for farm mortgages could be accomplished with little or no impact on federal budget outlays. The accompanying chart depicts the functions of participants in a secondary market for farm mortgages.

Functional Participation in a Secondary Market for Farm Mortgages



Borrower

- applies for farm mortgage loan for land or buildings

Loan Originator

- evaluates/appraises loan
- makes loan to borrower
- sells loan to pooler -- either all or a percentage
- continues to service loans for fees (optional)
- may share in loss on non-performing loans

Pooler

- reviews and buys loans; forms pools
- holds asset
- hedges risk
- sends pool to guarantor and certifies underwriting standards
- purchases guarantee
- issues public securities
- holds X% on a pooled basis in liquid reserve; sells Y% to investors
- monitors loan performance
- receives loan payments; pays investors
- takes X% share of loss on non-performing loans

Guarantor

- provides administration, policy making for secondary market with user input
- sets standards and criteria
- approves poolers and originators
- sells guarantee to poolers
- monitors poolers

Investor

- buys mortgage-backed securities

Let me illustrate to you briefly why a secondary market is vital to continuing participation by commercial lenders in farm and ranch loans. And why, without it, we may well see a shrinkage of our role to the point where it is no longer viable -- a situation that would certainly be unfortunate for us and for agriculture as well.

In 1968, insurance companies held about $5.5 billion in farm real estate, debt, or about 22 percent of the total. At the same time, federal land banks held about $5.6 billion, also 22 percent. Since that time, although our loaned amount has doubled to $11 billion, our share of the total has dropped to 15 percent in 1986 - two-thirds of its earlier level (and less when personal loans for farm mortgages are included). Meanwhile, federal land bank lending grew nearly nine times to 53 percent of the total market, down from a peak of 61 percent in 1982.

Two key conditions contributed to this change in market share:

1. Insurance company funds available for agricultural lending are limited by a company's total asset size, and the proportion of those assets that can be allocated to any particular investment. Farm mortgages are illiquid. Prudent management dictates that only so much of a company's assets can be placed in illiquid investments, particularly in a single industry.

2. Partly in response to agricultural expansion during the 1970s, federal land banks increased their lending rapidly. Their loan volume growth was made possible by their ability to source funds from the nation's capital markets. Federal agency status made these funds available at advantageous rates. And their practice of pricing loans based on an average cost of capital gave them a loan rate advantage in the risking rate environment of the latter '70s and early '80s.

In short, insurance companies had capital constraints partly due to investment illiquidity. Land banks had unlimited access to funds and lower rates. The shift of market share ensued. I cite these conditions to underline the necessity of liquidity and capital market access if a lender is to compete effectively in today's fast-paced and fluid financial markets.

To assess the merits of the secondary market concept for farm mortgages, the ACLI commissioned economists Stephen Gabriel and Paul Prentice of Farm Sector Economics Associates, a Bethesda, Maryland, consulting firm specializing in agricultural finance, to study the economic implications of creating a secondary market for farm mortgages.

As their study concludes, "creation of a secondary market for agricultural mortgages will give lenders needed liquidity to continue to provide long-term agricultural credit at competitive rates to qualified borrowers. To date, farm mortgages have not been pooled and packaged into securities to any substantial degree and, as a result, no major secondary market has developed for buying and selling farm mortgages."*

With the assistance of federal initiatives, the secondary market concept has worked very well for other long-term mortgage investments such as residential mortgages.

A secondary market offers advantages to all participants - from the farmer borrower to the lender to the investor. Although everyone will benefit, the study found that the greatest advantages will flow to the farmers. From the farmers' perspective, secondary market advantages include:

- Increased availability -- With access to new sources of funds through secondary markets, mortgage availability is increased regardless of local or national credit market conditions. Long-term, fixed-rate mortgages will become more available due to the liquidity of a secondary market.

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*Source: Preserving the Value of America's Farmland, An Economic Analysis of a Secondary Market for Farm Mortgages, Farm Sector Economics Associates, March 1987.

- Lower rates -- Greater fund availability automatically means borrowers pay lower interest rates than otherwise. Also, at least part of the greater efficiencies experienced by lenders will also be passed along to borrowers in the form of lower rates.

- Better service -- With more competition from increased funds and lower rates, lenders' services will also have to be more competitive. In general, this will result in more favorable mortgage terms, faster and more courteous service, and greater choice of mortgage terms and plans.

From the lenders' perspective, a secondary market will produce the following benefits:

- Higher yields -- When interest rates are rising, lenders can make new loans at higher rates by selling existing loans and reinvesting in new mortgages. Total yields to lenders are increased when they can turn over their portfolios rapidly. When rates are declining, lenders can collect the spread between the rate charged to the borrower and the yield required by purchasers of the loans.

- Increased originations -- Lenders may recapture up to 100 percent of their funds for reinvestment in new mortgages. This will provide lenders with liquidity, thus enabling them to originate more loans than otherwise possible. When primary market rates exceed secondary market rates, lenders can sell at a profit. This generates additional funds for lending with less capital.

- Increased profits -- With increased originations due to a secondary market, lenders increase their income from origination fees. The lender can also earn fee income from servicing the loans. This also increases the effective yield of the money available for investment.

- Efficiencies -- With larger loan portfolios from increased originations, the lender's average cost of servicing each additional loan is reduced. Costs can be spread over a greater volume. Economies of scale result in greater efficiency because the greater the volume, the lower the cost per transaction.

- Diversify Risk -- A secondary market allows for pooling of loans. The more diversity in any pool, the lower the risk. For a secondary market for pooled farm mortgages, lenders may choose to diversify by geographic location as well as by commodity type. This will reduce overall risk and therefore lead to lower interest rates.

In summary, key findings of the Farm Sector Economics Associates study are that creation of a secondary market for farm mortgages will:

- Preserve the value of farm assets, primarily farmland, shoring it up by $27.5 billion;
- Make available long-term, fixed-interest-rate loans to farmers;
- Reduce interest rates by 50 to 100 basis points (1/2-to-1 percent) on farm mortgages which meet requirements for securitization and by 17 basis points overall on new farm mortgages;
- Have little or no impact on federal budget outlays;
- Improve farmers' borrowing power without increasing production volume;
- Enhance competition among providers of

agricultural credit by allowing commercial banks and life insurance companies to continue their role in providing diversity to the farm mortgage market;

- Modernize agricultural lending by accessing national and international investment markets to attract a wide range of investors; and

- Restore balance between federal land banks and commercial lenders yet provide the federal land banks with some additional benefits:

    -- A new revenue source from fee income,

    -- Strengthened loan quality in their existing mortgage portfolios due to a stronger land market, and

    -- Flexibility in matching assets with loan obligations.

The study concludes that Federal support, through an explicit or implicit guarantee, is required to enhance acceptance of these securities by investors.

In the long run, American agriculture should be a full participant in all American capital markets. We believe creation of a secondary market for farm mortgages is clearly in the best interests of American agriculture as well as American taxpayers. It is essential to reverse the clear and present danger that American agriculture will become increasingly dependent on a single source of long-term credit.

STATEMENT OF

DON SCHIEBER

PONCA CITY, OKLAHOMA

before the Senate Agriculture Subcommittee on Credit

March 26, 1987

LONG TERM FARM LOAN REPAYMENT PROPOSAL

PROPOSAL
FOR
REPAYMENT OF LONG TERM LAND OWNERSHIP LOANS

This is a proposal to allow earlier repayment of long term land ownership loans similar to Federal Land Bank and FmHa loans. Earlier loan repayment is accomplished by allowing the borrower to split his loan payment into two equal sums. One sum is applied to principle and the other sum is applied to interest. This will leave a shortfall in the total amount of interest that is due annually. In the proposed plan interest and principle are equal until the 8th year when the interest is less than one-half of the annual payment. The only way this can be accomplished is with the help of a subsidy or a partial debt set-aside for a short period. The subsidy or the set-aside amount will be repaid in this plan when a 0 principle amount is reached at year 14. One requirement of the plan is that the borrower must still make the same annual installment. The amount required for subsidy will vary for each loan depending on which payment is currently due (such as payment 5, payment 6, payment 7). The farther into the repayment schedule, the less is required for subsidy. This is a great deviation from the standard 30 year plan where each year more of the annual payment is applied to interest than principle.

The following narrative, charts, and graphs explain the 30 year plan and the proposed plan. Both plans are discussed and focused on a $100,000 loan with a 12.%5 interest rate. This is done only for illustration and comparison as loans are made for any amount.

NARRATIVE
LONG TERM LOAN REPAYMENT

Since the agricultural financial situation has deteriorated to the present condition, the time has come for a close look into long term loan repayment. This study shows what is happening as loans are repaid, follows the loan as it progresses to repayment, and offers an alternative repayment plan. The loan that appears in this study is very similar to loans that are made by the Federal Land Bank and possibly the FmHA. All of the schedules and charts are based on a $100,000 loan, 12.5% interest rate, and a 30 year repayment schedule. The alternative offers solutions to the borrower in interest. Under this plan, the lender still receives all of his principle, only sooner. This has advantages to both parties. The borrower reduces debt and interest and increases his equity in his property which improves his financial statement. The lender receives a large principle installment annually and has a more secure loan with more activity. Under this plan, the borrower needs a little help, such as a principle delay for a maximum of 8 years on a portion, or a subsidy to be happening in the standard 30 year amortization and the new proposal.

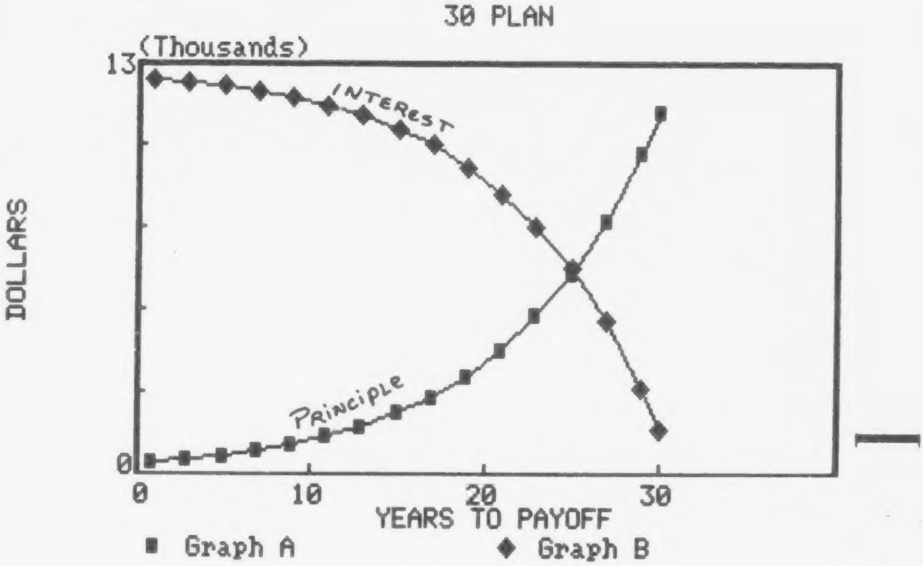
The chart on page 2 shows the amount of principle and interest paid each year plus the unpaid balance after the payment is made under the 30 year plan. The graph on page 3 shows the portion of the annual payment applied to principle and interest each year of the 30 year plan. The chart on page 4 shows the amount of principle, interest, and subsidy paid each year under the proposed plan as well as the unpaid balance. It also shows the repayment of the subsidy, total cost of both plans to the borrower, the savings of the proposed plan to the borrower, and the maximum amount of subsidy that could be required. The graph on page 5 shows how each annual payment is applied to principle and interest, and how the subsidy is used annually. Page 5 is a graphic illustration of the information on page 4. Page 6 is a graphic illustration of the annual unpaid balance under each plan.

It seems that the standard 30 year plan is fine as long as there is stable or rising land prices, but the way the annual payment is applied to loan service, it takes at least 24 years or payments to repay 50% of the principle. The other 50% is repaid in only 6 years. Under the proposed plan, 50% of the principle is repaid in only 8 years. This will have a definite affect on debt service as well as debt/asset ratio. Under the 30 year plan, the borrower has no chance to stay on top of debt/asset ratio under current agricultural conditions. The subsidy could be obtained either by a generic certificate from CCC or a short term set-aside by the lender. Either way, the subsidy is repaid by the borrower after year 14. It is repaid at the same annual installment and same interest rate. Keep in mind that the amount of subsidy is variable because not all borrowers are in the same year of repayment as it relates to 30 years. A borrower that has made 15 payments will require a very small amount compared to one that has made only 3 or 4 payments. The maximum that could be required is $25,962.88. If a short term set-aside is used, it should have little effect on the lender because the unpaid balance is still above $80000 under the 30 year plan when the subsidy is repaid under the proposed plan in year 17.

This proposal is complex and extensive study and thought may be required to understand it.

LOAN AMOUNT	INTEREST RATE	YEARS	PAYMENT AMOUNT
100,000.00	12.50	31.00	12,876.02

Pmt#	Mo.	Year	Principal	Interest	Balance
1	Jan.	2	376.02	12,500.00	99,623.98
2	Jan.	3	423.02	12,453.00	99,200.97
3	Jan.	4	475.89	12,400.13	98,725.07
4	Jan.	5	535.38	12,340.64	98,189.69
5	Jan.	6	602.30	12,273.72	97,587.39
6	Jan.	7	677.59	12,198.43	96,909.79
7	Jan.	8	762.29	12,113.73	96,147.50
8	Jan.	9	857.58	12,018.44	95,289.93
9	Jan.	10	964.77	11,911.25	94,325.15
10	Jan.	11	1,085.37	11,790.65	93,239.78
11	Jan.	12	1,221.04	11,654.98	92,018.74
12	Jan.	13	1,373.67	11,502.35	90,645.06
13	Jan.	14	1,545.38	11,330.64	89,099.68
14	Jan.	15	1,738.56	11,137.46	87,361.12
15	Jan.	16	1,955.88	10,920.15	85,405.25
16	Jan.	17	2,200.36	10,675.66	83,204.89
17	Jan.	18	2,475.40	10,400.62	80,729.48
18	Jan.	19	2,784.83	10,091.19	77,944.65
19	Jan.	20	3,132.93	9,743.09	74,811.72
20	Jan.	21	3,524.55	9,351.47	71,287.17
21	Jan.	22	3,965.12	8,910.90	67,322.05
22	Jan.	23	4,460.76	8,415.26	62,861.29
23	Jan.	24	5,018.35	7,857.67	57,842.94
24	Jan.	25	5,645.65	7,230.37	52,197.29
25	Jan.	26	6,351.35	6,524.67	45,845.93
26	Jan.	27	7,145.27	5,730.75	38,700.66
27	Jan.	28	8,038.43	4,837.59	30,662.23
28	Jan.	29	9,043.24	3,832.78	21,618.99
29	Jan.	30	10,173.64	2,702.38	11,445.35
30	Jan.	31	11,445.35	1,430.67	0.00

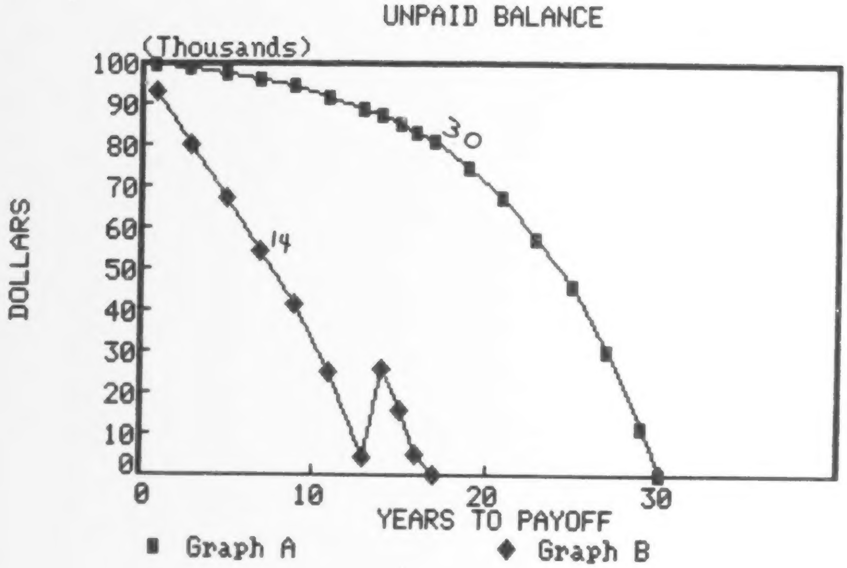

30 PLAN
(Thousands)
13
0
DOLLARS
INTEREST
PRINCIPLE
0
10
20
30
YEARS TO PAYOFF
■ Graph A
◆ Graph B

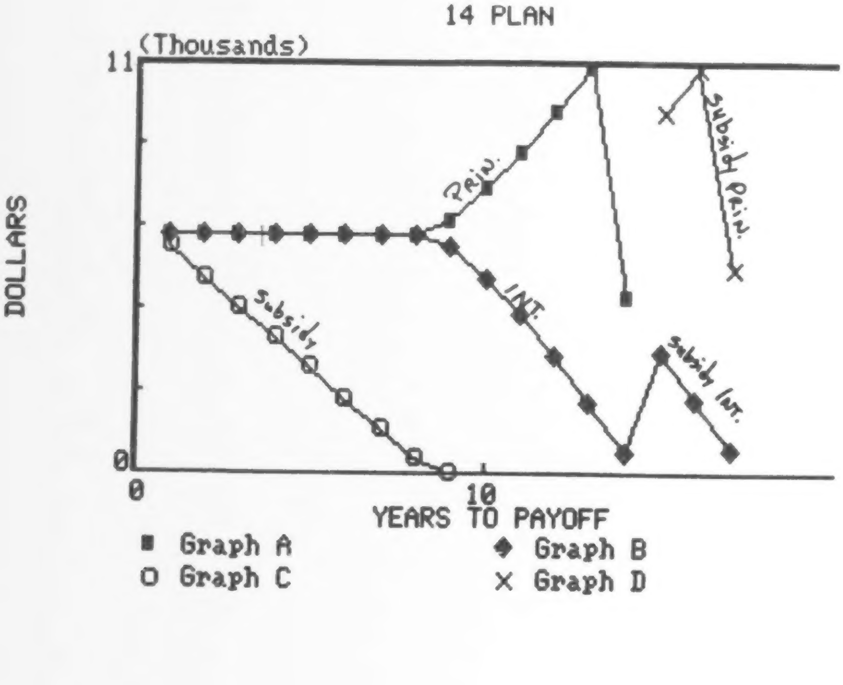
```
                   14 YEAR PAYMENT ANALYSIS
                  ANNUAL PAYMENT: $12876.02

  PMT#    PRINCIPLE       INTEREST     SUBSIDY      BALANCE
   1       6438.01        6438.01      6061.99     93561.99
   2       6438.01        6438.01      5257.24     87123.98
   3       6438.01        6438.01      4452.49     80685.97
   4       6438.01        6438.01      3647.74     74247.96
   5       6438.01        6438.01      2842.98     67809.95
   6       6438.01        6438.01      2038.23     61371.94
   7       6438.01        6438.01      1233.48     54933.93
   8       6438.01        6438.01       428.73     48495.92
   9       6814.03        6061.99         0.00     41681.85
  10       7665.78        5210.24         0.00     34016.07
  11       8624.01        4252.01         0.00     25392.06
  12       9702.01        3174.01         0.00     15690.05
  13      10914.76        1961.26         0.00      4775.29
  14       4775.29         596.91         0.00         0.00
-------------------------------------------------------------
  TOTAL INTEREST:                                 $72760.50
  TOTAL SUBSIDY:                                  $25962.88

                      SUBSIDY REPAYMENT
                  ANNUAL PAYMENT: $12876.02
                     INTEREST RATE: 12.5%

 PMT#     PRINCIPLE      INTEREST                   BALANCE
                                                   25962.88
  15       9632.66        3243.36                  16330.22
  16      10834.74        2041.28                   5495.48
  17       5495.48         686.94                      0.00
-------------------------------------------------------------
  TOTAL INTEREST:                                $  5971.58
  TOTAL PRINCIPLE:                               $100000.00
  TOTAL TO BORROWER:                             $204694.96
-------------------------------------------------------------
  TOTAL TO BORROWER IN 30 YR PLAN:               $386280.62
  TOTAL TO BORROWER IN 14 YR PLAN:               $204694.96
-------------------------------------------------------------
  TOTAL SAVINGS TO BORROWER:                     $181585.66
-------------------------------------------------------------
  TOTAL SUBSIDY REQUIRED:                        $ 25962.88
```


UNPAID BALANCE
(Thousands)
100
90
80
70
60
50
40
30
20
10
0
DOLLARS
0
10
20
30
YEARS TO PAYOFF
30
14
■ Graph A
◆ Graph B


14 PLAN
(Thousands)
11
0
DOLLARS
0
10
YEARS TO PAYOFF
PRIN.
INT.
Subsidy
Subsidy PRIN.
Subsidy INT.
■ Graph A
◆ Graph B
○ Graph C
× Graph D

9.5% Analysis
Annual Payment: $10,168.06

PMT#	PRINCIPLE	INTEREST	SUBSIDY	BALANCE
1	5084.03	5084.03	4415.97	94915.97
2	5084.03	5084.03	3932.99	89831.91
3	5084.03	5084.03	3450.00	84747.91
4	5084.03	5084.03	2967.02	79662.88
5	5084.03	5084.03	2484.04	74579.85
6	5084.03	5084.03	2001.06	69495.82
7	5084.03	5084.03	1518.07	64411.79
8	5084.03	5084.03	1035.09	59327.76
9	5084.03	5084.03	552.11	54243.73
10	5084.03	5084.03	69.12	49159.70
11	5497.89	4670.17	0.00	43661.81
12	6020.19	4147.87	0.00	37641.62
13	6592.11	3575.95	0.00	31049.51
14	7218.36	2949.70	0.00	23831.15
15	7904.10	2263.96	0.00	15927.05
16	8654.99	1513.07	0.00	7272.06
17	6581.21	690.85	0.00	0.00

TOTAL INTEREST: $70,651.87
TOTAL SUBSIDY: $22,425.47

SUBSIDY REPAYMENT
ANNUAL PAYMENT: $10,168.06
INTEREST RATE: 9.5%

PMT#	PRINCIPLE	INTEREST	BALANCE
18	8037.64	2130.42	22425.47
19	8801.22	1366.84	14387.83
20	5055.88	530.73	5586.61

TOTAL INTEREST: $ 4,027.99
TOTAL PRINCIPLE: $100,000.00
TOTAL TO BORROWER: $197,105.33

TOTAL TO BORROWER IN 30 YR. PLAN: $305,041.90
TOTAL TO BORROWER IN 20 YR. PLAN: $197,105.33

TOTAL SAVINGS TO BORROWER: $107,936.57

TOTAL SUBSIDY REQUIRED: $ 22,425.47

7% Analysis
Annual Payment: $8,058.65

PMT#	PRINCIPLE	INTEREST	SUBSIDY	BALANCE
1	4029.32	4029.32	2970.68	95970.68
2	4029.32	4029.32	2688.63	91941.36
3	4029.32	4029.32	2406.58	87912.04
4	4029.32	4029.32	2124.52	82882.72
5	4029.32	4029.32	1842.47	79853.40
6	4029.32	4029.32	1560.42	75824.08
7	4029.32	4029.32	1278.36	71794.76
8	4029.32	4029.32	996.31	67765.44
9	4029.32	4029.32	714.26	63736.12
10	4029.32	4029.32	432.21	59706.80
11	4029.32	4029.32	150.16	55677.48
12	4161.23	3897.42	0.00	51516.25
13	4452.51	3606.14	0.00	47063.74
14	4764.19	3294.46	0.00	42611.23
15	5075.86	2982.79	0.00	37535.37
16	5431.17	2627.48	0.00	32104.20
17	5811.36	2247.48	0.00	26292.84
18	6218.15	1840.50	0.00	20074.69
19	6653.42	1405.23	0.00	13421.27
20	7119.16	939.49	0.00	6302.11
21	6302.11	441.15	0.00	0.00

TOTAL PRINCIPLE: $100,000.00
TOTAL INTEREST: $ 67,604.47
TOTAL SUBSIDY: $ 17,164.60

SUBSIDY REPAYMENT
ANNUAL PAYMENT: $8058.32
INTEREST RATE: 7%

PMT#	PRINCIPLE	INTEREST	BALANCE
22	6857.13	1201.52	17,164.60
23	7337.13	721.52	10,307.47
24	2970.34	207.92	2,970.34

TOTAL INTEREST: $ 2,130.96
TOTAL PRINCIPLE: $100,000.00
TOTAL TO BORROWER: $186,900.03

TOTAL IN 30 YR. PLAN: $241,759.36
TOTAL IN 23 YR. PLAN $186,900.03

TOTAL SAVINGS TO BORROWER: $ 54,859.33
TOTAL SUBSIDY REQUIRED: $ 17,164.60

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O.S.U. LOAN CALCULATOR

   LOAN     INTEREST    INSTLMTS  YEARS       PAYMENT  :  TOTAL
  AMOUNT      RATE       PER YR   OF LN       AMOUNT   :  INTEREST
100,000.00    7.00         1        30       8,058.65    141,759.36

              LOAN          INTEREST           YEARS          PAYMENT
             AMOUNT             RATE                           AMOUNT
          100,000.00            7.00           30.00         8,058.65
 Pmth   Mo.   Year    Principal        Interest         Balance
 1      Jan.    2       1,058.64        7,000.00       98,941.36
 2      Jan.    3       1,132.75        6,925.90       97,808.61
 3      Jan.    4       1,212.04        6,846.61       96,596.58
 4      Jan.    5       1,296.89        6,761.77       95,299.70
 5      Jan.    6       1,387.66        6,670.98       93,912.04
 6      Jan.    7       1,484.80        6,573.85       92,427.24
 7      Jan.    8       1,588.73        6,469.91       90,838.50
 8      Jan.    9       1,699.95        6,358.70       89,138.56
 9      Jan.   10       1,818.94        6,239.70       87,319.62
10      Jan.   11       1,946.27        6,112.38       85,373.35
11      Jan.   12       2,082.51        5,976.14       83,290.84
12      Jan.   13       2,228.28        5,830.36       81,062.56
13      Jan.   14       2,384.26        5,674.38       78,678.30
14      Jan.   15       2,551.16        5,507.49       76,127.14
15      Jan.   16       2,729.74        5,328.91       73,397.40
16      Jan.   17       2,920.82        5,137.82       70,476.58
17      Jan.   18       3,125.28        4,933.37       67,351.30
18      Jan.   19       3,344.05        4,714.60       64,007.25
19      Jan.   20       3,578.13        4,480.51       60,429.12
20      Jan.   21       3,828.60        4,230.04       56,600.52
21      Jan.   22       4,096.60        3,962.04       52,503.91
22      Jan.   23       4,383.37        3,675.28       48,120.55
23      Jan.   24       4,690.20        3,368.44       43,430.35
24      Jan.   25       5,018.52        3,040.13       38,411.83
25      Jan.   26       5,369.81        2,688.83       33,042.02
26      Jan.   27       5,745.70        2,312.92       27,296.32
27      Jan.   28       6,147.90        1,910.75       21,148.42
28      Jan.   29       6,578.25        1,480.39       14,570.17
29      Jan.   30       7,038.73        1,019.92        7,531.44
              30     7,531.44          527.21            0.00
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O.S.U. LOAN CALCULATOR

  LOAN    INTEREST    INSTLMTS  YEARS      PAYMENT  :  TOTAL
 AMOUNT     RATE       PER YR   OF LN      AMOUNT   : INTEREST
100,000.00   7.50         1       30       8,467.13   154,013.87

                LOAN          INTEREST             YEARS          PAYMENT
               AMOUNT             RATE                             AMOUNT
           100,000.00             7.50              30.00         8,467.13
Pmth  Mo.    Year    Principal          Interest          Balance
 1    Jan.      2        967.12          7,500.01         99,032.88
 2    Jan.      3      1,039.66          7,427.47         97,993.22
 3    Jan.      4      1,117.63          7,349.50         96,875.59
 4    Jan.      5      1,201.45          7,265.67         95,674.13
 5    Jan.      6      1,291.56          7,175.57         94,382.57
 6    Jan.      7      1,388.43          7,078.70         92,994.14
 7    Jan.      8      1,492.56          6,974.57         91,501.57
 8    Jan.      9      1,604.51          6,862.62         89,897.07
 9    Jan.     10      1,724.84          6,742.29         88,172.23
10    Jan.     11      1,854.21          6,612.92         86,318.02
11    Jan.     12      1,993.27          6,473.86         84,324.75
12    Jan.     13      2,142.77          6,324.36         82,181.98
13    Jan.     14      2,303.48          6,163.65         79,878.50
14    Jan.     15      2,476.24          5,990.89         77,402.27
15    Jan.     16      2,661.95          5,805.18         74,740.31
16    Jan.     17      2,861.60          5,605.53         71,878.71
17    Jan.     18      3,076.22          5,390.91         68,802.49
18    Jan.     19      3,306.94          5,160.19         65,495.56
19    Jan.     20      3,554.96          4,912.17         61,940.60
20    Jan.     21      3,821.58          4,645.55         58,119.02
21    Jan.     22      4,108.20          4,358.93         54,010.83
22    Jan.     23      4,416.31          4,050.82         49,594.51
23    Jan.     24      4,747.54          3,719.59         44,846.98
24    Jan.     25      5,103.60          3,363.53         39,743.38
25    Jan.     26      5,486.37          2,980.76         34,257.01
26    Jan.     27      5,897.85          2,569.28         28,359.16
27    Jan.     28      6,340.19          2,126.94         22,018.97
28    Jan.     29      6,815.70          1,651.43         15,203.27
29    Jan.     30      7,326.88          1,140.25          7,876.39
             30      7,876.39          590.73           0.00-
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O.S.U. LOAN CALCULATOR

  LOAN     INTEREST    INSTLMTS   YEARS       PAYMENT   :  TOTAL
 AMOUNT      RATE       PER YR    OF LN       AMOUNT    : INTEREST
100,000.00   8.00         1         30       8,882.75    166,482.45

              LOAN          INTEREST             YEARS          PAYMENT
             AMOUNT             RATE                             AMOUNT
          100,000.00            8.00             30.00         8,882.75
 Pmth   Mo.   Year    Principal         Interest           Balance
 1      Jan.     2       882.74         8,000.00          99,117.26
 2      Jan.     3       953.36         7,929.39          98,163.89
 3      Jan.     4     1,029.63         7,853.12          97,134.26
 4      Jan.     5     1,112.00         7,770.75          96,022.26
 5      Jan.     6     1,200.96         7,681.79          94,821.30
 6      Jan.     7     1,297.04         7,585.71          93,524.26
 7      Jan.     8     1,400.80         7,481.95          92,123.45
 8      Jan.     9     1,512.87         7,369.88          90,610.59
 9      Jan.    10     1,633.90         7,248.85          88,976.69
10      Jan.    11     1,764.61         7,118.14          87,212.08
11      Jan.    12     1,905.78         6,976.97          85,306.31
12      Jan.    13     2,058.24         6,824.51          83,248.07
13      Jan.    14     2,222.90         6,659.85          81,025.17
14      Jan.    15     2,400.73         6,482.02          78,624.44
15      Jan.    16     2,592.79         6,289.96          76,031.65
16      Jan.    17     2,800.21         6,082.54          73,231.44
17      Jan.    18     3,024.23         5,858.52          70,207.21
18      Jan.    19     3,266.17         5,616.58          66,941.05
19      Jan.    20     3,527.46         5,355.29          63,413.59
20      Jan.    21     3,809.66         5,073.09          59,603.93
21      Jan.    22     4,114.43         4,768.32          55,489.50
22      Jan.    23     4,443.58         4,439.17          51,045.92
23      Jan.    24     4,799.07         4,083.68          46,246.85
24      Jan.    25     5,183.00         3,699.75          41,063.85
25      Jan.    26     5,597.64         3,285.11          35,466.22
26      Jan.    27     6,045.45         2,837.30          29,420.77
27      Jan.    28     6,529.09         2,353.67          22,891.69
28      Jan.    29     7,051.41         1,831.34          15,840.28
29      Jan.    30     7,615.52         1,267.23           8,224.76
             30     8,224.76         657.99              0.00-
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O.S.U. LOAN CALCULATOR

  LOAN     INTEREST    INSTLMTS  YEARS     PAYMENT  :  TOTAL
 AMOUNT     RATE       PER YR   OF LN     AMOUNT   : INTEREST
100,000.00   8.50         1        30      9,305.06    179,151.85

           LOAN          INTEREST          YEARS          PAYMENT
         AMOUNT              RATE                          AMOUNT
      100,000.00           8.50            31.00         9,305.06
Pmth  Mo.   Year   Principal         Interest          Balance
 1    Jan.    2       805.06          8,500.00        99,194.94
 2    Jan.    3       873.49          8,431.58        98,321.46
 3    Jan.    4       947.73          8,357.33        97,373.72
 4    Jan.    5     1,028.29          8,276.77        96,345.43
 5    Jan.    6     1,115.70          8,189.37        95,229.73
 6    Jan.    7     1,210.53          8,094.53        94,019.20
 7    Jan.    8     1,313.43          7,991.64        92,705.78
 8    Jan.    9     1,425.07          7,880.00        91,280.71
 9    Jan.   10     1,546.20          7,758.87        89,734.52
10    Jan.   11     1,677.62          7,627.44        88,056.89
11    Jan.   12     1,820.22          7,484.84        86,236.67
12    Jan.   13     1,974.94          7,330.12        84,261.73
13    Jan.   14     2,142.81          7,162.25        82,118.92
14    Jan.   15     2,324.95          6,980.11        79,793.97
15    Jan.   16     2,522.57          6,782.49        77,271.40
16    Jan.   17     2,736.99          6,568.07        74,534.41
17    Jan.   18     2,969.63          6,335.43        71,564.78
18    Jan.   19     3,222.05          6,083.01        68,342.73
19    Jan.   20     3,495.93          5,809.14        64,846.80
20    Jan.   21     3,793.08          5,511.98        61,053.72
21    Jan.   22     4,115.49          5,189.57        56,938.23
22    Jan.   23     4,465.31          4,839.75        52,472.92
23    Jan.   24     4,844.86          4,460.20        47,628.06
24    Jan.   25     5,256.67          4,048.39        42,371.39
25    Jan.   26     5,703.49          3,601.57        36,667.90
26    Jan.   27     6,188.29          3,116.78        30,479.62
27    Jan.   28     6,714.29          2,590.77        23,765.33
28    Jan.   29     7,285.00          2,020.06        16,480.32
29    Jan.   30     7,904.23          1,400.83         8,576.09
          30     8,576.09          728.97          0.00
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O.S.U. LOAN CALCULATOR

  LOAN    INTEREST    INSTLMTS  YEARS       PAYMENT   :  TOTAL
 AMOUNT     RATE       PER YR   OF LN       AMOUNT    : INTEREST
100,000.00   9.00        1        30       9,733.64     192,009.20

              LOAN          INTEREST           YEARS          PAYMENT
             AMOUNT             RATE                           AMOUNT
          100,000.00            9.00            30.00         9,733.64
 Pmth  Mo.   Year   Principal          Interest          Balance
 1     Jan.     2        733.64         9,000.00         99,266.36
 2     Jan.     3        799.66         8,933.98         98,466.70
 3     Jan.     4        871.63         8,862.01         97,595.07
 4     Jan.     5        950.06         8,783.56         96,644.99
 5     Jan.     6      1,035.59         8,698.05         95,609.41
 6     Jan.     7      1,128.79         8,604.85         94,480.62
 7     Jan.     8      1,230.38         8,503.26         93,250.24
 8     Jan.     9      1,341.11         8,392.53         91,909.12
 9     Jan.    10      1,461.81         8,271.83         90,447.31
10     Jan.    11      1,593.38         8,140.26         88,853.93
11     Jan.    12      1,736.78         7,996.86         87,117.15
12     Jan.    13      1,893.09         7,840.55         85,224.06
13     Jan.    14      2,063.47         7,670.17         83,160.59
14     Jan.    15      2,249.18         7,484.46         80,911.41
15     Jan.    16      2,451.61         7,282.03         78,459.80
16     Jan.    17      2,672.25         7,061.39         75,787.55
17     Jan.    18      2,912.76         6,820.88         72,874.79
18     Jan.    19      3,174.90         6,558.74         69,699.89
19     Jan.    20      3,460.65         6,272.99         66,239.24
20     Jan.    21      3,772.10         5,961.54         62,467.14
21     Jan.    22      4,111.59         5,622.05         58,355.55
22     Jan.    23      4,481.64         5,252.00         53,873.91
23     Jan.    24      4,884.98         4,848.66         48,988.93
24     Jan.    25      5,324.63         4,409.01         43,664.29
25     Jan.    26      5,803.85         3,929.79         37,860.45
26     Jan.    27      6,326.19         3,407.45         31,534.25
27     Jan.    28      6,895.55         2,838.09         24,638.70
28     Jan.    29      7,516.15         2,217.49         17,122.55
29     Jan.    30      8,192.61         1,541.03          8,929.94
              30     8,929.94             803.70          0.00-
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D.S.U. LOAN CALCULATOR

   LOAN    INTEREST    INSTLMTS  YEARS       PAYMENT   :  TOTAL
  AMOUNT     RATE       PER YR   OF LN       AMOUNT    : INTEREST
100,000.00   9.50         1        30      10,168.06     205,041.90

                LOAN          INTEREST             YEARS          PAYMENT
              AMOUNT              RATE                             AMOUNT
          100,000.00              9.50              31.00       10,168.06
 Pmth   Mo.    Year    Principal            Interest            Balance
  1     Jan.      2          668.06          9,500.00          99,331.94
  2     Jan.      3          731.52          9,436.54          98,600.42
  3     Jan.      4          801.02          9,367.04          97,799.40
  4     Jan.      5          877.12          9,290.95          96,922.28
  5     Jan.      6          960.44          9,207.62          95,961.84
  6     Jan.      7        1,051.68          9,116.38          94,910.16
  7     Jan.      8        1,151.59          9,016.47          93,758.56
  8     Jan.      9        1,260.99          8,907.07          92,497.57
  9     Jan.     10        1,380.79          8,787.27          91,116.78
 10     Jan.     11        1,511.96          8,656.10          89,604.82
 11     Jan.     12        1,655.60          8,512.46          87,949.22
 12     Jan.     13        1,812.88          8,355.18          86,136.33
 13     Jan.     14        1,985.11          8,182.96          84,151.23
 14     Jan.     15        2,173.69          7,994.37          81,977.53
 15     Jan.     16        2,380.19          7,787.87          79,597.34
 16     Jan.     17        2,606.31          7,561.75          76,991.03
 17     Jan.     18        2,853.91          7,314.15          74,137.12
 18     Jan.     19        3,125.03          7,043.03          71,012.09
 19     Jan.     20        3,421.91          6,746.15          67,590.18
 20     Jan.     21        3,746.99          6,421.07          63,843.19
 21     Jan.     22        4,102.96          6,065.11          59,740.23
 22     Jan.     23        4,492.74          5,675.33          55,247.49
 23     Jan.     24        4,919.55          5,248.52          50,327.95
 24     Jan.     25        5,386.90          4,781.16          44,941.04
 25     Jan.     26        5,898.66          4,269.40          39,042.38
 26     Jan.     27        6,459.03          3,709.03          32,583.35
 27     Jan.     28        7,072.64          3,095.42          25,510.71
 28     Jan.     29        7,744.54          2,423.52          17,766.17
 29     Jan.     30        8,480.27          1,687.79           9,285.90
                 30     9,285.90          882.17              0.00
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D.S.U. LOAN CALCULATOR

  LOAN     INTEREST    INSTLMTS   YEARS        PAYMENT   :  TOTAL
 AMOUNT      RATE       PER YR    OF LN        AMOUNT    : INTEREST
100,000.00  10.00          1        30      10,607.93      218,237.89

                LOAN           INTEREST             YEARS          PAYMENT
              AMOUNT               RATE                             AMOUNT
          100,000.00              10.00              30.00       10,607.93
Pmth   Mo.   Year    Principal         Interest          Balance
 1     Jan.     2        607.92       10,000.00         99,392.08
 2     Jan.     3        668.72        9,939.21         98,723.36
 3     Jan.     4        735.59        9,872.34         97,987.77
 4     Jan.     5        809.15        9,798.78         97,178.62
 5     Jan.     6        890.06        9,717.87         96,288.56
 6     Jan.     7        979.07        9,629.86         95,309.49
 7     Jan.     8      1,076.98        9,530.95         94,232.51
 8     Jan.     9      1,184.67        9,423.26         93,047.84
 9     Jan.    10      1,303.14        9,304.79         91,744.70
10     Jan.    11      1,433.45        9,174.47         90,311.24
11     Jan.    12      1,576.80        9,031.13         88,734.44
12     Jan.    13      1,734.48        8,873.45         86,999.96
13     Jan.    14      1,907.93        8,700.00         85,092.03
14     Jan.    15      2,098.72        8,509.21         82,993.31
15     Jan.    16      2,308.59        8,299.34         80,684.72
16     Jan.    17      2,539.45        8,068.48         78,145.27
17     Jan.    18      2,793.40        7,814.53         75,351.87
18     Jan.    19      3,072.74        7,535.19         72,279.13
19     Jan.    20      3,380.01        7,227.92         68,899.12
20     Jan.    21      3,718.01        6,889.92         65,181.11
21     Jan.    22      4,089.81        6,518.12         61,091.29
22     Jan.    23      4,498.80        6,109.13         56,592.50
23     Jan.    24      4,948.68        5,659.25         51,643.82
24     Jan.    25      5,443.54        5,164.39         46,200.28
25     Jan.    26      5,987.90        4,620.03         40,212.38
26     Jan.    27      6,566.69        4,021.24         33,625.69
27     Jan.    28      7,245.36        3,362.57         26,380.34
28     Jan.    29      7,969.89        2,638.04         18,410.45
29     Jan.    30      8,766.88        1,841.05          9,643.57
            30     9,643.57          964.36          0.00-
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O.S.U. LOAN CALCULATOR

   LOAN     INTEREST      INSTLMTS   YEARS        PAYMENT   :   TOTAL
  AMOUNT      RATE         PER YR    OF LN        AMOUNT    :  INTEREST
100,000.00    10.5            1        30       11,052.85     231,585.59

                 LOAN           INTEREST            YEARS          PAYMENT
                AMOUNT              RATE                            AMOUNT
            100,000.00             10.50            31.00        11,052.85
 Pmth    Mo.    Year    Principal            Interest           Balance
  1      Jan.      2           552.85        10,500.00          99,447.15
  2      Jan.      3           610.90        10,441.96          98,836.25
  3      Jan.      4           675.04        10,377.81          98,161.21
  4      Jan.      5           745.92        10,306.93          97,415.29
  5      Jan.      6           824.24        10,228.61          96,591.05
  6      Jan.      7           910.79        10,142.07          95,680.26
  7      Jan.      8         1,006.42        10,046.43          94,673.84
  8      Jan.      9         1,112.09         9,940.76          93,561.75
  9      Jan.     10         1,228.86         9,823.99          92,332.89
 10      Jan.     11         1,357.90         9,694.96          90,974.99
 11      Jan.     12         1,500.47         9,552.38          89,474.51
 12      Jan.     13         1,658.02         9,394.83          87,816.49
 13      Jan.     14         1,832.12         9,220.74          85,984.37
 14      Jan.     15         2,024.49         9,028.36          83,959.88
 15      Jan.     16         2,237.06         8,815.79          81,722.82
 16      Jan.     17         2,471.95         8,580.90          79,250.87
 17      Jan.     18         2,731.51         8,321.35          76,519.36
 18      Jan.     19         3,018.32         8,034.54          73,501.05
 19      Jan.     20         3,335.24         7,717.61          70,165.81
 20      Jan.     21         3,685.44         7,367.41          66,480.37
 21      Jan.     22         4,072.41         6,980.44          62,407.96
 22      Jan.     23         4,500.01         6,552.64          57,907.95
 23      Jan.     24         4,972.51         6,080.34          52,935.43
 24      Jan.     25         5,494.63         5,558.23          47,440.81
 25      Jan.     26         6,071.56         4,981.29          41,369.24
 26      Jan.     27         6,709.08         4,343.78          34,660.17
 27      Jan.     28         7,413.53         3,639.32          27,246.64
 28      Jan.     29         8,191.95         2,860.90          19,054.68
 29      Jan.     30         9,052.11         2,000.75          10,002.58
               30     10,002.58        1,050.28            0.00
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O.S.U. LOAN CALCULATOR

   LOAN    INTEREST    INSTLMTS  YEARS      PAYMENT   :  TOTAL
 AMOUNT     RATE        PER YR   OF LN      AMOUNT    : INTEREST
100,000.00  11.00         1        30      11,502.46    245,073.95

              LOAN          INTEREST           YEARS         PAYMENT
            AMOUNT              RATE                          AMOUNT
         100,000.00          11.00             30.00       11,502.46
Pmth   Mo.    Year   Principal          Interest          Balance
 1     Jan.      2        502.46        11,000.00        99,497.54
 2     Jan.      3        557.73        10,944.73        98,939.81
 3     Jan.      4        619.08        10,883.38        98,320.73
 4     Jan.      5        687.18        10,815.29        97,633.55
 5     Jan.      6        762.77        10,739.70        96,870.78
 6     Jan.      7        846.67        10,655.79        96,024.11
 7     Jan.      8        939.81        10,562.66        95,084.30
 8     Jan.      9      1,043.19        10,459.28        94,041.11
 9     Jan.     10      1,157.94        10,344.53        92,883.17
10     Jan.     11      1,285.31        10,217.15        91,597.86
11     Jan.     12      1,426.70        10,075.77        90,171.17
12     Jan.     13      1,583.63         9,918.83        88,587.54
13     Jan.     14      1,757.83         9,744.63        86,829.70
14     Jan.     15      1,951.19         9,551.27        84,878.51
15     Jan.     16      2,165.82         9,336.64        82,712.69
16     Jan.     17      2,404.06         9,098.40        80,308.62
17     Jan.     18      2,668.51         8,833.95        77,640.11
18     Jan.     19      2,962.05         8,540.42        74,678.07
19     Jan.     20      3,287.87         8,214.59        71,390.19
20     Jan.     21      3,649.54         7,852.93        67,740.65
21     Jan.     22      4,050.99         7,451.48        63,689.67
22     Jan.     23      4,496.60         7,005.87        59,193.07
23     Jan.     24      4,991.22         6,511.24        54,201.85
24     Jan.     25      5,540.26         5,962.21        48,661.59
25     Jan.     26      6,149.68         5,352.78        42,511.91
26     Jan.     27      6,826.15         4,676.31        35,685.76
27     Jan.     28      7,577.03         3,925.44        28,108.73
28     Jan.     29      8,410.50         3,091.97        19,698.23
29     Jan.     30      9,335.65         2,166.81        10,362.58
              30     10,362.58        1,139.89         0.00-
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O.S.U. LOAN CALCULATOR

   LOAN     INTEREST    INSTLMTS  YEARS      PAYMENT   :  TOTAL
  AMOUNT      RATE       PER YR   OF LN      AMOUNT    : INTEREST
100,000.00   11.50         1        30     11,956.41     258,692.44

               LOAN          INTEREST            YEARS          PAYMENT
              AMOUNT             RATE                            AMOUNT
            100,000.00          11.50            30.00        11,956.41
 Pmth   Mo.    Year    Principal          Interest          Balance
  1     Jan.     2          456.41        11,500.00        99,543.59
  2     Jan.     3          508.90        11,447.52        99,034.69
  3     Jan.     4          567.42        11,388.99        98,467.27
  4     Jan.     5          632.67        11,323.74        97,834.60
  5     Jan.     6          705.43        11,250.98        97,129.17
  6     Jan.     7          786.56        11,169.86        96,342.62
  7     Jan.     8          877.01        11,079.41        95,465.61
  8     Jan.     9          977.86        10,978.55        94,487.74
  9     Jan.    10        1,090.32        10,866.10        93,397.42
 10     Jan.    11        1,215.71        10,740.71        92,181.72
 11     Jan.    12        1,355.51        10,600.90        90,826.20
 12     Jan.    13        1,511.40        10,445.02        89,314.81
 13     Jan.    14        1,685.21        10,271.21        87,629.60
 14     Jan.    15        1,879.01        10,077.41        85,750.60
 15     Jan.    16        2,095.09         9,861.32        83,655.50
 16     Jan.    17        2,336.03         9,620.39        81,319.48
 17     Jan.    18        2,604.67         9,351.74        78,714.81
 18     Jan.    19        2,904.21         9,052.21        75,810.60
 19     Jan.    20        3,238.19         8,718.22        72,572.41
 20     Jan.    21        3,610.58         8,345.83        68,961.83
 21     Jan.    22        4,025.80         7,930.62        64,936.03
 22     Jan.    23        4,488.77         7,467.65        60,447.26
 23     Jan.    24        5,004.97         6,951.44        55,442.29
 24     Jan.    25        5,580.55         6,375.87        49,861.74
 25     Jan.    26        6,222.31         5,734.11        43,639.43
 26     Jan.    27        6,937.87         5,018.54        36,701.56
 27     Jan.    28        7,735.73         4,220.68        28,965.83
 28     Jan.    29        8,625.34         3,331.08        20,340.49
 29     Jan.    30        9,617.25         2,339.16        10,723.24
                30     10,723.24         1,233.18          0.00-
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O.S.U. LOAN CALCULATOR

  LOAN    INTEREST    INSTLMTS  YEARS      PAYMENT  :  TOTAL
 AMOUNT     RATE      PER YR    OF LN      AMOUNT   : INTEREST
100,000.00  12.00        1        30     12,414.37    272,431.12

               LOAN         INTEREST           YEARS         PAYMENT
              AMOUNT          RATE                            AMOUNT
          100,000.00          12.00            30.00       12,414.37
Pmt#   Mo.   Year    Principal        Interest         Balance
 1     Jan.     2       414.37      12,000.00       99,585.63
 2     Jan.     3       464.09      11,950.28       99,121.54
 3     Jan.     4       519.78      11,894.59       98,601.76
 4     Jan.     5       582.15      11,832.22       98,019.61
 5     Jan.     6       652.01      11,762.36       97,367.60
 6     Jan.     7       730.25      11,684.12       96,637.34
 7     Jan.     8       817.88      11,596.49       95,819.46
 8     Jan.     9       916.03      11,498.34       94,903.43
 9     Jan.    10     1,025.95      11,388.42       93,877.47
10     Jan.    11     1,149.07      11,265.30       92,728.41
11     Jan.    12     1,286.96      11,127.41       91,441.45
12     Jan.    13     1,441.39      10,972.98       90,000.06
13     Jan.    14     1,614.36      10,800.01       88,385.70
14     Jan.    15     1,808.08      10,606.29       86,577.61
15     Jan.    16     2,025.05      10,389.32       84,552.56
16     Jan.    17     2,268.06      10,146.31       82,284.50
17     Jan.    18     2,540.23       9,874.15       79,744.28
18     Jan.    19     2,845.05       9,569.32       76,899.23
19     Jan.    20     3,186.46       9,227.91       73,712.77
20     Jan.    21     3,568.83       8,845.54       70,143.94
21     Jan.    22     3,997.09       8,417.28       66,146.84
22     Jan.    23     4,476.74       7,937.63       61,670.10
23     Jan.    24     5,013.95       7,400.42      -56,656.14
24     Jan.    25     5,615.63       6,798.74       51,040.51
25     Jan.    26     6,289.50       6,124.87       44,751.01
26     Jan.    27     7,044.24       5,370.13       37,706.77
27     Jan.    28     7,889.55       4,524.82       29,817.21
28     Jan.    29     8,836.30       3,578.07       20,980.91
29     Jan.    30     9,896.66       2,517.71       11,084.26
            30    11,084.26       1,330.12           0.00-
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O.S.U. LOAN CALCULATOR

   LOAN      INTEREST    INSTLMTS  YEARS       PAYMENT   :  TOTAL
  AMOUNT       RATE      PER YR    OF LN       AMOUNT    :  INTEREST
100,000.00     12.50        1        30      12,876.02      286,280.62

               LOAN           INTEREST           YEARS            PAYMENT
              AMOUNT              RATE                             AMOUNT
            100,000.00           12.50           30.00          12,876.02
 P. #   Mo.   Year   Principal          Interest          Balance
  1     Jan.    2        376.02         12,500.00        99,623.98
  2     Jan.    3        423.02         12,453.00        99,200.97
  3     Jan.    4        475.89         12,400.13        98,725.07
  4     Jan.    5        535.38         12,340.64        98,189.69
  5     Jan.    6        602.30         12,273.72        97,587.39
  6     Jan.    7        677.59         12,198.43        96,909.79
  7     Jan.    8        762.29         12,113.73        96,147.50
  8     Jan.    9        857.58         12,018.44        95,289.93
  9     Jan.   10        964.77         11,911.25        94,325.15
 10     Jan.   11      1,085.37         11,790.65        93,239.78
 11     Jan.   12      1,221.04         11,654.98        92,018.74
 12     Jan.   13      1,373.67         11,502.35        90,645.06
 13     Jan.   14      1,545.38         11,330.64        89,099.68
 14     Jan.   15      1,738.56         11,137.46        87,361.12
 15     Jan.   16      1,955.88         10,920.15        85,405.25
 16     Jan.   17      2,200.36         10,675.66        83,204.89
 17     Jan.   18      2,475.40         10,400.62        80,729.48
 18     Jan.   19      2,784.83         10,091.19        77,944.65
 19     Jan.   20      3,132.93          9,743.09        74,811.72
 20     Jan.   21      3,524.55          9,351.47        71,287.17
 21     Jan.   22      3,965.12          8,910.90        67,322.05
 22     Jan.   23      4,460.76          8,415.26        62,861.29
 23     Jan.   24      5,018.35          7,857.67        57,842.94
 24     Jan.   25      5,645.65          7,230.37        52,197.29
 25     Jan.   26      6,351.35          6,524.67        45,845.93
 26     Jan.   27      7,145.27          5,730.75        38,700.66
 27     Jan.   28      8,038.43          4,837.59        30,662.23
 28     Jan.   29      9,043.24          3,832.78        21,618.99
 29     Jan.   30     10,173.64          2,702.38        11,445.35
            30     11,445.35         1,430.67            0.00-
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O.S.U. LOAN CALCULATOR

  LOAN     INTEREST    INSTLMTS  YEARS      PAYMENT   :  TOTAL
 AMOUNT      RATE       PER YR   IN YRS     AMOUNT    : INTEREST
100,000.00  13.00         1        30     13,341.07     300,232.10

              LOAN          INTEREST          YEARS          PAYMENT
             AMOUNT             RATE                          AMOUNT
          100,000.00           13.00           30.00       13,341.07
Pmt#   Mo.   Year    Principal         Interest          Balance
 1     Jan.     2       341.07        13,000.00        99,658.93
 2     Jan.     3       385.40        12,955.67        99,273.53
 3     Jan.     4       435.51        12,905.56        98,838.02
 4     Jan.     5       492.12        12,848.95        98,345.90
 5     Jan.     6       556.10        12,784.97        97,789.81
 6     Jan.     7       628.39        12,712.68        97,161.42
 7     Jan.     8       710.08        12,630.99        96,451.34
 8     Jan.     9       802.39        12,538.68        95,648.94
 9     Jan.    10       906.70        12,434.37        94,742.24
10     Jan.    11     1,024.57        12,316.50        93,717.67
11     Jan.    12     1,157.77        12,183.30        92,559.90
12     Jan.    13     1,308.28        12,032.79        91,251.62
13     Jan.    14     1,478.35        11,862.72        89,773.27
14     Jan.    15     1,670.54        11,670.53        88,102.73
15     Jan.    16     1,887.71        11,453.36        86,215.02
16     Jan.    17     2,133.11        11,207.96        84,081.90
17     Jan.    18     2,410.42        10,930.65        81,671.49
18     Jan.    19     2,723.77        10,617.30        78,947.71
19     Jan.    20     3,077.86        10,263.21        75,869.25
20     Jan.    21     3,477.98         9,863.09        72,391.87
21     Jan.    22     3,930.12         9,410.95        68,461.74
22     Jan.    23     4,441.04         8,900.03        64,020.71
23     Jan.    24     5,018.37         8,322.70        59,002.33
24     Jan.    25     5,670.76         7,670.31        53,331.57
25     Jan.    26     6,407.96         6,933.11        46,923.61
26     Jan.    27     7,241.01         6,100.06        39,682.62
27     Jan.    28     8,182.33         5,158.75        31,500.29
28     Jan.    29     9,246.03         4,095.04        22,254.26
29     Jan.    30    10,448.01         2,893.06        11,806.25
             30     11,806.25         1,534.82         0.00-
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